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2553
No. 12054

United States
Court of Appeals

for the Ninth Circuit

PACIFIC PORTLAND CEMENT COMPANY,
a corporation,

Appellant,

VS.

WESTVACO CHLORINE PRODUCTS COR-
PORATION, a corporation,

Appellee.

Transcript of Record

(In Three Volumes)

VOLUME II

(Pages 457 to 900, inclusive)

Appeal from the United States District Court
for the Northern District of California
Southern Division

FILED
FEB 16 1949

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(Testimony of C. Bruce Flick.)

Q. That is one of the items that is included in overhead expense by Westvaco, is it?

A. Yes.

Q. Then as to any unaccounted for time or services in the laboratory, such as you have in the shipping department, say a laboratory superintendent, you would object to any charge of that character against gypsum because it would have to be allocated on some basis, is that right?

A. No, if gypsum is considered—We are talking now about joint products.

Q. No, I am talking about gypsum. You just conceded that direct charges would be proper although gypsum is a by-product, is that right?

A. Yes.

Q. On the same hypothesis, assuming without conceding that gypsum is a by-product, if I understand your testimony, then, you would not object to the direct charges, but you would object to indirect charges, such as the salary of a laboratory supervisor, for the reason that you would have to allocate that on some basis, is that right?

A. For the reason that the basis principle of by-product—

Q. Do not give me the reason—

Mr. Bennett: Let him answer. [427]

Mr. Rosenberg: He is saying "for the reason." I do not know if he is answering "Yes" or "No," yet.

Mr. Bennett: After all, you are not testifying, Counsel. Let the witness testify.

(Testimony of C. Bruce Flick.)

The Court: Just a moment. Let the reporter read the question.

(Question read.)

A. Not for the reason that you have to allocate, but for the reason that if you quit making the by-product you would still have that expense.

Q. (Mr. Rosenberg): Let us take accounting. There is an accounting department at the Newark plant, is there? A. Correct.

Q. And a portion of their services are devoted to the keeping of records and invoices and checking your debit memos and things of that sort pertaining to gypsum, is that right?

A. I assume so.

Q. Is it your position that no part of that expense is properly chargeable to gypsum?

A. No part of that expense which you would have anyway if you quit making gypsum is properly chargeable to the by-product gypsum.

Q. Let us assume that we would hire a girl to do nothing but keep the accounts and the records pertaining to gypsum, although it might not require her full time. Then under those circumstances you would say that that would be a proper expense to gypsum, would you?

A. Not a part of cost of manufacture. She is not manufacturing gypsum and there would be perhaps a question as to the nature of the accounting work she did. If she is checking our debit memos, she is not manufacturing gypsum.

Q. But it would be a proper expense?

A. Not as part of cost of manufacture. It would be an overhead item.

(Testimony of C. Bruce Flick.)

Q. Let us take this question as an expert question, forgetting about Westvaco.

The Court: Pardon me.

Mr. Rosenberg: Yes, your Honor.

The Court: He said it would be an overhead.

Mr. Rosenberg: Oh, it would be an overhead.

The Court: Isn't that the answer?

Mr. Rosenberg: That is the answer.

The Court: Pardon me. I do not want to inject myself.

Q. That would be a proper charge on overhead?

A. That would be what we call an overhead. I am distinguishing between that and the cost of manufacture.

Q. Yes, but it would be a proper charge?

A. To overhead. Now, there is a further question as to allocating it, or whether it should be allocated at all.

Q. (Mr. Rosenberg): As I have understood your previous testimony, Mr. Flick, you have conceded, have you not, that ordinarily, [429] and eliminating any question of a by-product, overhead is a proper item to be included in determining cost of production, isn't that true?

Mr. Bennett: In the case of a principal or co-product.

Mr. Rosenberg: I said, eliminating a by-product.

Mr. Bennett: Oh, not in the case of a by-product.

Mr. Rosenberg: May that answer go in as the witness' answer, Mr. Bennett?

(Testimony of C. Bruce Flick.)

Mr. Bennett: I wanted to get the question clear. Apparently there is some confusion about it. You are reviewing the situation. The witness has stated, as I understand, several times that there is a definite line and difference between——

The Court: If there is any question about it, clear it up in your own way.

Mr. Bennett: ——including overhead allocations he says proper.

Mr. Rosenberg: Mr. Bennett, may I ask the witness rather than you?

Mr. Bennett: Well, all right, I will have to object perhaps to the form of the question.

The Court: There is nothing before the court at this time. Let us proceed.

Q. (Mr. Rosenberg): As I correct in stating that you have stated as an expert that in the manufacture of a principal product or the manufacture of joint or co-products, overhead [430] expense is properly included in determining cost of production?

A. That is, the overhead expense right at the plant where the product is made.

Q. That is true, is it?

A. Yes. We have exemplified that by Gerlach.

Q. One of the things you mentioned is we included in overhead our personnel department that had to do with employing people and getting deferments for them during the war, and if I can cut this short, will you tell me whether I am correct in this, that you would agree that that would be a

(Testimony of C. Bruce Flick.)

proper expense in the case of a major product of a co-product but you believe that it is improper in the case of a by-product, is that right?

A. Correct, because you would still have it if you quit making the by-product.

Q. Yes. Now, when you were testifying the other day you stated that you felt that the sulphuric acid charge was not a proper charge to the cost of production of gypsum, and one of the reasons that you gave is that Dr. Seaton stated in his article, which we have referred to previously, the sulphuric acid was added because the bittern had a slight and variable alkalinity which made its processing difficult. Now, therefore, if you are primarily producing a major product and you have this material to make the processing, to facilitate the processing for the major product, again should not be charged as cost of manufacture of the by-product. Do you remember giving that testimony? [431]

A. I believe so.

Q. What major product were you talking about when you said that Dr. Seaton said sulphuric acid was necessary to the manufacture of a main product?

A. The point I had in mind is this, that the sulphuric acid being added to the bittern to improve the condition of it for its further processing would perhaps facilitate the removal of the impurities, which would thereby benefit the main product.

Q. What main product were you talking about?

A. Magnesium oxide, for which the plant was primarily designed.

(Testimony of C. Bruce Flick.)

Q. Isn't it a fact that when Dr. Seaton made the statement to which you referred he was not talking about magnesium oxide at all, was he?

A. He was talking about the whole plant operation.

Q. Was he? A. Certainly.

Q. Show me where he said that.

A. He described first the bromine and then the magnesium oxide and then he referred to the by-product gypsum.

Q. Where is the statement to which you referred when you said that Dr. Seaton said that the sulphuric acid was added because the bittern had a slight and variable alkalinity, which made its processing difficult.

A. "The raw bittern has a slight and variable alkalinity, which makes its further processing difficult. Accordingly, from the [432] storage ponds, it is pumped to a large surge tank, from which it issues as a controlled stream into which the necessary quantity of concentrate sulphuric acid to give essential neutrality is introduced by a proportioning pump?

Q. Isn't it true, Mr. Flick, that that which you just read is a portion of a paragraph commencing as follows:

"Recovery of bromine from bittern, is carried on at all three plants of the California Chemical Corporation,"—

And isn't it true that from that point on Dr. Seaton went on to discuss and explain the process for

(Testimony of C. Bruce Flick.)

the recovery of bromine, and that the excerpt that you just read had relation to Dr. Seaton's dissertation upon the recovery of bromine rather than magnesium oxide, isn't that true?

A. Bromine was the beginning of the dissertation. He did not stop with bromine. Let me read this:

"Exit liquor from the bromine recovery towers has essentially the same composition as the raw bittern with the exception that its small bromine content has been replaced with chlorine. Some 3 percent dilution by condensed steam also has occurred. Both Newark and Chula Vista plants process this liquor for magnesium chloride recovery."

Q. Now, you have been over the plant and, as explained before, there are three processes: The first one is bromine. The bittern first goes to the bromine plant, isn't that correct? [433]

A. That is what I understood, yes.

Q. After it leaves the bromine plant and the bromine has been recovered it goes to the gypsum plant, does it?

A. That is my understanding.

Q. And what Dr. Seaton was talking about——

A. You are using the present tense. It should be the past tense, because they are not making the bromine now, are they?

Q. No, they are not. As a matter of fact, at the time this article was written in 1931 they did not even have a plant for gypsum and magnesium, did they, at Newark?

(Testimony of C. Bruce Flick.)

A. They were making gypsum then, were they not?

Q. In a pilot plant, were they not?

A. Yes, the basic process is the same.

Q. They were not making commercial gypsum, were they?

A. I really do not know in 1931, but he refers to it. I understand the chemical process was the same.

The Court: It is time for adjournment. We will adjourn until two o'clock.

(A recess was thereupon taken until two o'clock p.m.)

Tuesday, December 16, 1947, 2:00 p.m.

C. BRUCE FLICK

resumed the stand.

Cross Examination (Continued)

The Court: You may proceed.

Q. (Mr. Rosenberg): Mr. Flick, getting back to this Newark plant, as I stated before, when the bromine towers are working, there is a process that precedes the first process that is shown on here, that is taking bittern water and recovering the bromine from it.

A. That is my understanding.

Q. All of these processes at the Newark plant start in with this bittern water; is that correct?

A. Yes. The bittern water comes in and goes through the bromine towers when they are operating and then on to the next stage and so on.

(Testimony of C. Bruce Flick.)

Q. Then to gypsum and then to magnesia. This bittern water is, I believe you explained the other day, concentrated sea water that remains after the Leslie Salt Company has taken salt out of the sea water?

A. That is my understanding.

Q. That bittern itself, that is the residue, we might say, that remains in the Leslie Salt plant after they have taken salt out; is that right?]435]

A. I think so.

Q. And it is something that is simply incidental in the Leslie Salt plant from the production of salt?

A. Well, I hesitate to talk about the Leslie Salt, because I really don't know their operation.

Q. Well, assuming their process is to take the sea water and collect it in ponds and let it lie there until a certain portion of the natural salt has been precipitated, then they take off the remaining water which is the bittern and collect the salt; assuming that to be the fact, this remaining liquid, which is bittern, that would be a by-product of the Leslie Salt Company, wouldn't it?

A. It sounds like it.

Q. So in the Newark plant, as a matter of fact, the processes start with the use of a liquid that is in itself a by-product of another plant; is that right? A. That may well be.

Q. And as far as the Leslie Salt Company is concerned, that bittern water would be a valueless waste, would it not, unless they sold it to Westvaco? A. Well, I don't know.

(Testimony of C. Bruce Flick.)

Q. You know of no other use that it would have?

A. I don't know; I am just ignorant about its alternate uses for sale of the bittern water. I understand that the bittern water is sold to Westvaco. As far as other alternatives, I [436] really don't know.

Q. Well, it would have no commercial use as such unless something were done to it, would it?

A. I don't know that.

Q. Well, assuming that to be the fact, you do know this, don't you, that common salt—what is the chemical term, is it sodium chloride?

A. Sodium chloride, I believe.

Q. The bittern that comes to the Westvaco plant after Leslie has taken out, we will say, most of the sodium chloride, contains certain chemicals, does it? A. Yes.

Q. It contains—what does it contain, do you know?

A. It contains several elements. The article of Dr. Seaton that we spoke of shows two analyses and says that it contains among other elements magnesium sulphate and chloride.

Q. At least to the extent that your answers have indicated the processes at the Newark plant may be distinguished from the process at the Gerlach plant; is that a fact?

A. Very definitely.

Q. In other words, you stated in your testimony of the other day, I believe, that the Newark

(Testimony of C. Bruce Flick.)

plant you start with your mined quarried gypsum, that is a product that is naturally of some value whether you process it or not, there is no stage of the production where you have a valueless raw material; is [437] that what you stated the other day?

A. You misspoke yourself. You said Newark. You meant Gerlach.

Q. Yes. Gerlach.

A. At the Gerlach plant we start with rock which is brought out from the quarry and the distinction that I was trying to make, the apparent distinction was that at no time in the Gerlach production of joint products is there a removal of waste from which any product results or from which any product is produced, whereas at the Newark plant the by-product gypsum is made by drying and grinding something which would be a valueless waste if it were not processed.

Q. In other words, you said in your testimony the other day that at no stage of the process at the Gerlach plant do you have a valueless raw material because the gypsum could be sold as such for agricultural purposes without being processed——

A. Yes, you could grind up gypsum rock and sell it. Gypsum deposits are there and people may be permitted to come and get it and pay for it and haul it away.

Q. Will you concede that there is some distinction in these processes in this chemical plant at Newark in that the basic material from which you

(Testimony of C. Bruce Flick.)

start all your processes is in itself a valueless waste material?

A. No, it is not valueless because it is being sold for money to Westvaco. [438]

Q. That, in your opinion, alters it from being a valueless waste, is that it?

A. Well, it obviously has value if Leslie Salt Company collects dollars for it.

Q. The same is true of gypsum, isn't it?

Mr. Bennett: That is argumentative.

Mr. Rosenberg: Withdraw that.

Mr. Bennett: In fact, gypsum after it is ground and dried is, of course, of value. That is the very basis of this contract.

Mr. Rosenberg: May I have Exhibit 4, please?

The Witness: Your Honor, may I revert for a moment to an answer just before the recess?

The Court: Yes.

The Witness: Just before the recess we were speaking of the bittern going through bromine towers and then on to the next stage and on to other steps and on to the gypsum plant. What I have in mind always when I use the term "the gypsum plant" is the unit where the drying and grinding occurred, and obviously, the bittern never goes on to that gypsum plant. I just wanted to be sure the record does not show the confusion. The bittern goes first to the bromine towers when they are in operation and then on to the next stage in the process. The bittern never goes to what we understand is meant by the term "gypsum plant."

(Testimony of C. Bruce Flick.)

The gypsum plant, as I understand it, is the [439] unit in the plant where the gypsum is ground and dried and, obviously, the bittern never goes there.

Q. (By Mr. Rosenberg): But the bittern goes to the tower, the precipitation vats where the bittern is precipitated out of the fluid, is that right?

A. The bittern is not precipitated.

Q. I mean the gypsum.

A. The bittern goes into the big tanks where the gypsum is precipitated and then you still have to filter out the material from which the byproduct gypsum is made which, as I understand it, is the filter cake.

Q. Now, throughout your testimony you have stated that, according to good accounting principles, in determining the cost of a byproduct, overhead should not be included. That is the substance of your statement?

A. That is a good general principle.

Q. Will you tell me what authority you have for that opinion, Mr. Flick; have you read text writers or articles or court decisions, or what is the basis for your expert opinion as to what is good accounting practice for byproducts?

A. Well, I think that initially I indicated my education and my experience, like with the study of accounting at the University of California under Henry Rand Hatfield and John F. Forbes, subsequent employment with Haskins & Sells, one of our best known national public accounting firms and many years of [440] experience as an accounting

(Testimony of C. Bruce Flick.)

and financial, fiscal officer in corporations where they dealt with different companies for the purpose of audit, Price, Waterhouse & Company, Lybrand Ross Bros. & Montgomery, or Haskins & Sells, and in general an acquaintance with most of the accounting profession such as George P. Carruthers and George Keast and various others, and my own background, naturally, in the course of those years and reading periodicals and one thing and another.

Q. You do read articles and periodicals on cost accounting, I presume?

A. From time to time.

Q. Can you refer us to a treatise or text writer who has stated, as you have, that in determining cost of production of a byproduct, it is improper to include overhead?

A. I cannot quote you at the moment any particular citations.

Q. In other words, you have no authority for your opinion that you can designate at this time except your own individual opinion placed against the background that you have just mentioned of your experience and contacts with other persons in the profession; is that it?

A. I am not prepared to cite specific authorities at this moment.

Q. Let me ask you if you will disagree with this statement, Mr. Flick. [441]

The word byproduct is troublesome in accounting terminology. Frequently byproducts are of con-

(Testimony of C. Bruce Flick.)

siderable value. They may even be worth more than the so-called main products from which they derive. In byproduct coke operation the coke produced sells for less than the cost of the coal from which it is made. The implication in the word "byproduct" that a product is merely nominal because it is incidental to the obtainment of some other may lead to superficial accounting treatment. Such products are better regarded as joint products, differing, it is true, in importance, and value as well as nature, but nevertheless meriting equal consideration as products. [442]

Q. Would you agree with that?

Mr. Bennett: I suppose counsel in line with previous questions is reading or purporting to read from some article that somebody has written. According to my remembrance, it is never proper to cross-examine a witness about some authority, something someone else has said unless it is shown that the witness has based his opinion upon what the author has said. I think that principle has been well established in the rules of evidence and requires no citations. If Your Honor wishes citations, I will supply them.

The Court: What is it you are reading from?

Mr. Rosenberg: At this point, Your Honor, I will say it is an extract from an authority and I concede when and if I use the authority as for the purpose of impeachment, I am obligated to disclose the authority. There is no question about that, but I think I am entitled to ask this witness

(Testimony of C. Bruce Flick.)

as an expert whether he agrees with this as a statement. If I have any authority from which I have derived this and I desire to use it as a means of impeachment, certainly I must disclose the authority, but I submit at this point I am under no obligation in putting this as an abstract question and asking this expert if he agrees with that as a correct statement, a correct statement of that proposition.

Mr. Bennett: Your Honor, I think there is a further objection. If I still carry in mind what was read, he is trying [443] to get by an entirely different factual situation than here. In his hypothetical situation he is dealing with a product where counsel or the author states that by reason of certain physical facts the so-called different product, byproduct, may be a co-or principal product and that it may be treated as a byproduct. There is nothing in the evidence so far that this calcium sulphate which is the impurity removed from the bittern water to make possible the production of the primary product defined in the contract, that the evidence also shows that it would be a valueless waste unless there were something done to it, that was a declaration by the defendant's executive vice president.

The Court: Read the question.

(Question read.)

Mr. Rosenberg: That is an abstract question which I am asking an expert to state whether or not he agrees with.

(Testimony of C. Bruce Flick.)

The Court: Overruled.

A. No, I don't agree with it.

Mr. Rosenberg: You would not agree with it.

Q. Mr. Flick, you know this book, the official publication of the National Association of Cost Accountants, do you? A. No, I do not.

Q. This may have been reprinted somewhere, but this appears as in Volume 1, No. 1, under date of August, 1920, and it is National Association of Cost Accountants' official publication. [444]

A. 1920.

Q. Yes, and the article is entitled "Accounting for Byproducts." Have you ever read that article?

A. No, I have not. That was published 27 years ago.

Q. Yes.

Mr. Bennett: Counsel, are you going to cross-examine the witness or attempt to impeach the witness by anything that is written or said there?

Mr. Rosenberg: I think I will ask him if he agrees or disagrees——

Mr. Bennett: I think before you even proceed I should object. I am entitled to object. I previously stated the rule, if Your Honor please, that the witness has not been shown to have based his opinion on any document, report, so-called authority, textbook or the like; where that is so he may not be cross-examined with reference to what may be contained or said in any such book or document or text because it is improper cross-examination and for the further reason that it is an

(Testimony of C. Bruce Flick.)

indirect and improper way of getting before the Court improper evidence.

The Court: Nothing before the Court, gentlemen.

Mr. Bennett: The reason I made the objection, I wanted to object before cross-examination started, before counsel started to read or comment upon specific excerpts, if any, from this particular document; that has nothing to do with the witness' [445] testimony to date.

Mr. Rosenberg: Let me ask you, Mr. Flick, if you would disagree with this statement that is contained in this article to which I direct your attention.

Mr. Bennett: If Your Honor please, I make the same objection, not proper cross-examination; no proper foundation has been laid; it is improper, irrelevant and immaterial.

The Court: In what respect has not the foundation been laid?

Mr. Bennett: Well, it has been definitely shown, Your Honor, that the witness has not read this book, that his testimony is not based upon anything that is said in the book.

The Court: You will concede he is an expert?

Mr. Bennett: Yes, yes, Your Honor, very definitely.

The Court: I will allow the question.

Q. (By Mr. Rosenberg): Will you agree with this statement to which I direct your attention: "Many byproducts, however, rank nearly as high in

(Testimony of C. Bruce Flick.)

importance as the main products. This is true, for example, in the packing and coal and oil and chemical industries." Would you agree with that?

A. "Many byproducts rank nearly as high in importance as the main products." I suppose that is true.

Q. It is true in the chemical——

A. I don't know that it is true in any particular industry. It might be in any particular situation. [446]

Q. Would you agree with this statement——

Mr. Bennett: May my objection go——

The Court: It will go to all this line of testimony.

Mr. Bennett: So that I am not deficient in my duty as counsel to move to strike the answers of the witness before and any other answer that is responsive to these questions upon the same ground that I urged the objection.

The Court: Very well.

Mr. Bennett: The objections and the motions to all questions and answers of this character.

The Court: Let the record so show.

Q. (By Mr. Rosenberg): Would you agree with this statement: "It is difficult to lay down any hard and fast rules for byproduct accounting which can be generally followed because each plant has individual peculiarities to be considered. The same method of accounting will not be acceptable for two plants in the same industry for the rea-

(Testimony of C. Bruce Flick.)

son the product may not be processed in the same way.”

Would you agree with that?

A. I think that I will agree to this extent, where you differentiate, as that statement does, to say that in two different plants the product may not be processed in the same way, you may have a distinction between whether it is actually a by-product or not, but there are certain general principles of accounting applicable to byproducts as distinguished from joint [447] products or main products or co-products.

Q. I would like to read this again, where the author says, “It is difficult to lay down any hard and fast rules for byproduct accounting.” He is talking there of byproduct accounting?

A. Yes, but read the rest of the sentence.

Q. “Which can be generally followed because each plant has individual peculiarities to be considered. The same methods of accounting may not be suitable for two plants in the same industry for the reason the product may not be processed in the same way.”

A. Well, “hard and fast rules.” In accounting it is true that there are no hard and fast rules in the sense that accountants can look in a rule book and find the answer without considering the proper circumstances, if I make myself clear on that. There are generally accepted accounting principles applicable to byproducts. Now, the accountant as an accountant in any particular plant knows

(Testimony of C. Bruce Flick.)

what the facts of production are in order to decide whether those principles are applicable. For example, in this case it is clear that they are applicable carried to this byproduct gypsum.

Q. What are applicable to byproduct gypsum?

A. These principles of accounting for byproducts.

Q. Do you concede there is only one accepted method recognized by accounting authorities for the accounting for a byproduct? [448]

A. I don't know what you mean when you say one accepted authority. There are several principles which are applicable to accounting for the cost of production of a byproduct. We have covered those pretty well here.

Q. That is what I mean. Is it your opinion there is uniformity of opinion between accountants as to the accounting to be employed in byproduct accounting?

A. There are generally accepted principles of byproduct accounting.

Q. One of the principles is the one you mentioned, that no overhead or indirect costs are to be included.

A. One of the principles is this, that you don't charge anything to a byproduct prior to the period of separation. The next principle——

Q. Well, let's stop there.

Mr. Bennett: Let him finish.

Mr. Rosenberg: All right.

The Witness: The next principle is, that is this one, the one you just referred to. The next prin-

(Testimony of C. Bruce Flick.)

ciple is that you charge to the cost of production of the byproduct the actual charge. out of pocket expense which you are put to because you elect to process the byproduct material so to give it some value rather than simply dump it as a waste. Now, the cost of producing the byproduct, those costs are any expenses which are out of pocket due to your processing it, but they do not [449] include any indirect or overhead expenses which you would have anyway if you quit making the byproduct or if you dumped the byproduct material into the Bay, or overhead which you would have anyway or which you might have in a lesser but unascertainable amount.

Q. You believe that there is uniformity among accounting authorities as to those principles which you just announced, do you?

Mr. Bennett: I object to that as argumentative and not proper cross-examination, whether there is uniformity of all authorities or not. Well, I will withdraw the objection.

The Witness: I will say it is the other——

The Court: Did you withdraw your question?

Mr. Rosenberg: No.

Mr. Bennett: I withdrew my objection.

The Court: You may answer.

The Witness: The question is whether I think there is uniformity among accounting authorities as to byproduct accounting principles?

Mr. Rosenberg: As you have stated.

A. I think that it is quite obvious that there is not absolute uniformity because we have here

(Testimony of C. Bruce Flick.)

a case of Westvaco which ignores the byproduct character of the gypsum in its cost and then under their own accounting system which I have been told was approved by Peat, Marwick & Mitchell, elects to treat the [450] byproduct as if it were a joint product.

Q. Have you ever heard of that being done?

A. I heard of it in the case of Westvaco.

Q. And nowhere else?

A. I don't know of any other case.

Q. Now, I will direct your attention to here at page 7; the author has a heading, "General Methods of Accounting for Byproducts," and says:

"Three general methods of accounting for by-products are discussed in this publication. They may be designated respectively as (1) no costs; (2) preparation for sale, selling and administrative cost; and (3) total cost."

Mr. Bennett: Your Honor, before counsel reads further and to avoid the indirect and improper way of getting before Your Honor and going into improper lines where somebody, some person unidentified, he is not under oath, we don't know what his qualifications are, makes some statement, obviously it is improper for the defendant to inject something like this before Your Honor without any facts and without any foundation, it is to avoid the situation of getting before the Court all evidence that should come before the Court and getting in something——

The Court: If I followed the testimony, the witness on the stand indicated that this book was

(Testimony of C. Bruce Flick.)

27 years old. He is familiar with the book. [451]

Mr. Bennett: He says he has never seen it, he has never read it.

The Court: He does not need to see it.

Mr. Bennett: Never heard of it before.

The Court: He does not need to. He is an expert witness. He is seeking to frame a question and ask if he agrees with that principle. The witness on the stand is an expert.

Mr. Bennett: I understand that. The reason I mention as a basis for my objection—it is the rule that is always applied by the Court when the expert is examined——

The Court: I agree with you.

Mr. Bennett: Counsel has not done as he should do. I am just asking in the light of it that he lay the foundation. Now he takes this book and attempts to show to Your Honor this is something written by somebody who knew all about it and this is what he says—it is the vice of getting before the Court unsworn testimony, testimony that is not identified.

The Court: Well, usually courts do not make the admission that I am about to make. I need all the information that I can get on this field of expert testimony in relation to accounting and it was because of that reason that I indicated at the outset I allow the widest latitude that I can within the rules. The only comfort you can get from it is that we are developing a record here.

Mr. Bennett: I am trying to develop the record

(Testimony of C. Bruce Flick.)

for Your [452] Honor's benefit rather than the record's.

The Court: I have had these problems here and as far as I have gone, I cannot see any abuse. The very crux of this case, the very heart of it is now being developed. For that reason I am liberal in allowing the testimony.

Mr. Bennett: We are going to produce to Your Honor some additional experts on this question.

The Court: He asked if he agreed with a statement.

Mr. Bennett: I know, but what he is doing is to impart to Your Honor that he is reading some authoritative work.

The Court: That we have already developed. It is 27 years old. It may be of some value. [453]

Q. (By Mr. Rosenberg): Mr. Bennett said the author of the work does not appear. May I direct your attention, Mr. Flick, to the fact that it is stated here, "This publication has been prepared by the research department of the Association," which is the National Association of Cost Accountants, "from information received in reply to a questionnaire sent to certain members of the Association on the subject of accounting for byproducts, and from other material in the possession of the research department."

That is a common type of publication for the National Association of Cost Accountants to issue, isn't it?

Mr. Bennett: If Your Honor please, I object.

(Testimony of C. Bruce Flick.)

Mr. Rosenberg: All right. I will withdraw it.

Mr. Bennett: I understand my objections and motions to strike run through the course of this testimony without repetition.

The Court: All through this testimony.

Q. (By Mr. Rosenberg): I just call your attention to the fact that this publication speaks of three methods of accounting for byproducts, and the author states: "The first method of byproduct accounting, which probably is used more than any other, is to record only the sales and sales returns of byproducts. One general account or a separate account for each byproduct may be kept, depending on the variety of byproducts sold, and the extent to which the management wishes to go in obtaining [454] data for analysis. The excessive sales over sales returns—that is, the net sales—is usually closed into the current profit and loss account and entered in the 'other income' or 'miscellaneous income' section of the profit and loss statement instead of being treated as a reduction of 'manufacturing costs.' This method may therefore be called the 'no cost' method because the manufacturing costs, and the selling and administrative expenses of the byproducts are not separated from the costs and expenses of the main products."

Now, that is one of the methods of byproduct accounting that you mentioned, is it, Mr. Flick, where you merely credit the net return from the sale of your byproduct and use it as a reduction of cost of production or your main product, is that right?

(Testimony of C. Bruce Flick.)

A. Yes, I mentioned that particularly in connection with a type of byproduct which did not require processing.

Q. Yes.

A. Where you have something in the way of a byproduct material which you could sell without having to process it.

Q. Let me ask if you ever heard of this second method of byproduct accounting:

“The second method of accounting for byproducts differ from the first in that it records the cost of making byproducts salable after they have split off from the main product, the expenses of selling them and the portion of administrative [455] expenses applicable to them. The advantage of the second method over the first is that it gives more information, but neither the first nor the second method indicates the manufacturing costs of the byproducts prior to the time they separate from the main products.”

Is that in effect the method that you have been advocating, that is, only charging direct costs after the time that the so-called byproduct has been separated from the main product?

A. Yes. This, however, mentions expense of selling and the portion of the administrative expense. In all of my testimony we have been talking only about the cost of production of the byproduct or the cost of manufacture of the byproduct.

Mr. Bennett: May I add, Your Honor, as a further basis for my objection, which is the contract

(Testimony of C. Bruce Flick.)

provision. It is apparent from what counsel has read from this book that that had to do with accounting involving selling costs and other things.

The Court: I realize that we are limited to this contract. There is no sales department entering into our problem.

Q. (By Mr. Rosenberg): Let me ask you if you ever heard of a third method that is discussed in this volume:

“The chief feature of the third method of by-product accounting is that it separates the costs of byproducts from the costs of main products, from the very first manufacturing step. Under the first two methods, the costs of main products [456] and byproducts are combined until the point of physical separation is reached. In many cases, however, it is difficult to calculate precisely the costs of byproducts prior to physical separation and consequently, even under the third method, arbitrary initial cost values must often be assigned to byproducts. In some cases these values are regarded as only the ‘material cost of byproducts.’ They may, however, be the manufacturing costs if the byproducts require no further treatment before sale. Under the third method, perpetual inventories of byproducts are kept, which will show quantities and values. The method should not be adopted unless it will be practicable. This depends upon the degree of accuracy which can be attained without needless ‘hair-splitting’ over details, and

(Testimony of C. Bruce Flick.)

upon the relative value of the byproducts in comparison with that of the main product.”

If I understood your testimony before, you had never heard of any accepted accounting practice where anything was charged to the byproduct prior to the point of separation, is that right?

A. I do not know whether I said I never heard of it. I think I said it is recognized good accounting practice not to charge to the cost of production of the byproduct anything prior to the point of separation.

Q. Will you concede that there are at least authorities who contend that the cost of manufacturing the byproduct should [457] include the costs prior to the point of separation?

A. No. I have never found any such authorities.

Q. Let me read you the summary of the third method which we have just read.

A. May I say I do not regard any book written 27 years ago as an authority under today's conditions and all that has happened in the interim.

Q. Do you have anything more current that you can recommend?

A. At the moment I told you I am not prepared to give you citations.

Q. Do you recall reading anything currently that is to the contrary?

A. I told you I am not prepared to give you citations at the moment.

Q. Wouldn't you recognize this as being pretty good authority until you find something better?

(Testimony of C. Bruce Flick.)

A. No, sir, that is not my way of taking authorities.

Q. All right. Let us read what the research department of the National Association of Cost Accountants has to say under the heading of "Summary of the Third Method," to which I just referred:

"Under the third method byproducts generally are charged (1) material, at an arbitrary value if necessary; (2) labor expended on the byproduct after it separates from the main product; (3) an equitable proportion of overhead, and (4) a [458] proper share of selling and administrative expense, when these items are applied to the various products or classes of products on the basis of manufacturing costs."

Would you disagree with that method of accounting?

A. I very definitely disagree, and when they use terms like "you must" or "assign arbitrary values, if necessary," I do not think you can assume that those words apply to circumstances such as we have been concerned with.

Q. Would you disagree with the author's conclusion:

"On the whole, however, the third method is more logical and it gives information which is of vital importance in the administrative control of the business. A majority of the members of the Association who expressed their views on this matter stated their preference for the third method."

(Testimony of C. Bruce Flick.)

Would you disagree that a majority of the accountants, at least at that time, agreed that the third method that is referred to in that work was the preferable and better—

Mr. Bennett: Just a moment.

Mr. Rosenberg: May I finish my question?

Mr. Bennett: I thought you were through.

Q. (By Mr. Rosenberg, continuing): —is the preferable and better method for cost accounting for byproducts?

Mr. Bennett: Just a moment. Again, Your Honor understands that my objection to the previous questions of similar nature run to this whole line. I think I should add the further objection [459] here that he is asking this witness whether he agrees that the majority of accountants agreed to some statement. How can this witness know that and how is it fair to get before this Court that the majority of this board or whatever it was, said something? There is no proper foundation for that evidence being presented to the Court.

Mr. Rosenberg: I will withdraw that and ask the witness whether, in the light of what you have read, you will agree that there are many reputable cost accountants who are of the opinion it is good accounting practice for a byproduct to include overhead expense.

Mr. Bennett: Same objection that I have given before, and it is improper cross-examination, incompetent, irrelevant and immaterial.

The Court: The objection is overruled. You may answer.

(Testimony of C. Bruce Flick.)

A. When you ask me if there are many cost accountants, all I can say is that the concepts of good and generally accepted accounting principles for byproduct accounting, which I have been trying to explain here on the stand, are those which I understand to be generally accepted as good practice. You can always find people who may do something which is not in accordance with such generally accepted practice. I cannot say whether you may find some cost accountants who vary, but the general principles and application that I have been trying to outline here have been what I understand to be generally [460] accepted good accounting practice for byproduct cost accounting.

Q. (By Mr. Rosenberg): But you can't recall anything by way of treatise, text or otherwise that you have read in which it has been stated that where you are determining the cost of a byproduct that requires processing, in order to make it a commercial product, it is improper to include overhead expense, is that right?

A. It is improper to——

Q. Wait. I say, can you recall any treatise or text writer who has so stated?

A. I told you before, Mr. Rosenberg, I am not prepared to give you specific citations today. That page you showed me on that third method, you will read objections to it. My eye caught the phrase "objections to the third method," which you did not read.

(Testimony of C. Bruce Flick.)

Q. I am not contending, Mr. Flick,—don't misunderstand me—that there is uniformity among accountants as to how byproduct accounting is to be handled. On the other hand, I very definitely contend that it is a very complex subject, as to which there is not the uniformity of opinion that you seem to imply. Now, what was it you wanted to point out here (handing the book referred to to the witness)?

A. "The following objections have been made to this third method. It is difficult in many cases to determine the cost of the byproduct even approximately," that is to say, by the [461] use of that third method.

Q. Let us read the full statement that the author made before stating the conclusion.

Mr. Bennett: I object to that upon all the grounds on which I objected before. Call a witness. Let him be sworn, and let me cross-examine him and not get in unsworn testimony.

Mr. Rosenberg: All right. I withdraw that.

Q. Mr. Flick, you testified in January, 1944, I believe it was, that you had this conference for the purpose of checking this price increase at that time. Among other things you stated that in looking at the files when you first came to the company you found this letter, I believe it is of October 2, 1941, and some other things in Mr. Canvin's files, and among other things you mentioned that letter from Mr. Barrows under date of June 5, 1946, and

(Testimony of C. Bruce Flick.)

will you tell me whether or not any of the conclusions that you arrived at were in any wise influenced by the reading of that letter?

Mr. Bennett: You mean now, counsel, is the conclusion——

Mr. Rosenberg: As to what items are and are not properly to be included in cost of production of gypsum.

Mr. Bennett: Counsel, I think the witness is entitled to this. The witness has testified to two things here: One, the position he has taken with reference to the contract in question, the reasons why he has objected to the items or many of the items, these indirect charges generally that have been [462] charged or sought to be charged by your client against the cost of production of gypsum; he has also testified here as an expert as to his opinion as to what, in accordance with good accounting practice, the term “cost of production” and “actual increase or advance in cost of manufacture of the byproduct gypsum” means. Now, in which category of the testimony of the witness do you direct your question?

Mr. Rosenberg: I am directing my question to the fact that out of, I believe, a 78 per cent increase he decided that we were entitled to 29 cents and we were not entitled to 49 cents, and I want to know whether or not in arriving at that conclusion he was influenced in any degree whatever by the Barrows letter.

(Testimony of C. Bruce Flick.)

The Court: In the interest of time, he may answer. The objection is overruled.

(Question read.)

A. After I made my first examination in January, 1944, I learned for the first time what accounts Westvaco had on their books and what they were charging against the cost of production of this byproduct gypsum. Prior to that time I had only the information which has been referred to in the files, and the previous information showed only these direct items of labor, fuel, power, whatever they were. When I went down there in January of 1944 and found what they were charging to the cost of production, I took the position particularly, based upon my [463] understanding of good accounting practice and how a good accountant would define that term, "cost of production," I took the position that the direct charges, which had increased 29 cents for 1943 over 1942, were proper and that the price should be increased 29 cents on that account. I took the position, based upon my understanding of good accounting applicable here, that these allocations and indirect charges, which would have gone on anyway, even if the byproduct had been pumped into the Bay, were not properly chargeable. There has never been, in other words,— I have never made any attempt to try to build up, for purposes of this contract, anything which was incompatible and in which I personally did not believe as a good accountant.

Q. (By Mr. Rosenberg): Do I understand from that answer that you were or were not influenced

(Testimony of C. Bruce Flick.)

in any degree by the Barrows letter? Were you or were you not?

A. I was influenced, as I have said, by what I considered to be proper accounting under the circumstances and under the contract.

Q. So that the Barrows letter had nothing to do with your expert opinion in that respect, is that true?

A. Now, wait. It had nothing to do with my expert opinion. It had nothing whatever to do with my forming my opinion as an accountant.

Q. You have testified in a number of instances that during the [464] course of the conversations that you had with Mr. Williams and Mr. Wallace that you expressed your willingness and desire to comply with the contract and to try to work the thing out so as to avoid controversy, and it is true also both Mr. Williams and Mr. Wallace expressed the same attitude, isn't that right?

A. They have always expressed the same attitude but they always refused to arbitrate.

Mr. Rosenberg: I think that is all, Your Honor.

The Court: We will take a recess.

(Recess.)

Mr. Bennett: Your Honor, ordinarily I would with the redirect examination of Mr. Flick, but we have an expert witness here, the certified public accountant, who has certain engagements tomorrow that will prevent him from being here and I wonder if I might suspend temporarily the redirect examination of Mr. Flick and put this witness on out of order?

Mr. Rosenberg: I have no objection.

Mr. Bennett: Mr. Webster, will you take the stand, please?

PAUL K. WEBSTER

called as a witness on behalf of the plaintiff, and being first duly sworn, testified as follows:

Q. (By the Clerk): Will you state your name?

A. Paul K. Webster. [465]

Direct Examination

By Mr. Bennett:

Q. Where do you reside, Mr. Webster?

A. San Mateo, California.

Q. What is your business or occupation?

A. I am a member of the firm of Haskins & Sells, certified public accountants.

Q. That firm has an office in San Francisco?

A. Yes, an office in San Francisco and a number of others located throughout the country and in foreign countries.

Q. It might be said, then, to be a national or international firm of certified public accountants?

A. That is correct.

Q. Are you a certified public accountant?

A. Yes, sir.

Q. How long have you been such, Mr. Webster?

A. Nearly 20 years.

Q. Will you just briefly state to His Honor your preparation, training and experience in the field of accounting?

A. I have been associated with the firm of Haskins & Sells for somewhat more than 20 years. I

(Testimony of Paul K. Webster.)

have been a member of the firm for seven years, during which time I have been engaged in the execution of audit engagements, and more recently in the supervision of audit engagements, the development of programs relating to audit engagements, general consultation with clients relating to accounting practices and preparation and [466] review of tax returns and that sort of thing.

I am a graduate of the University of Southern California and spent some time as an instructor of accounting at that institution, and more recently have conducted classes in auditing in accounting subjects to a minor extent at the Extension Division of the University of California and at Golden Gate College in San Francisco.

I have had some experience in general book-keeping and accounting matters prior to entering the public accounting field, but for the past 21 or more years have been engaged exclusively in the practice of public accounting.

Your accounting experience has embraced a field, has it, of determining the proper methods and technique of determining cost of production of products, manufactured products?

A. Yes, my experience has been rather wide in that it covers industrial accounting in a number of industries as well as other types of accounting, such as utilities and financial institutions.

Q. Have you considered from time to time the proper technique to be employed in the cost ac-

(Testimony of Paul K. Webster.)

counting or the determination of cost of production or the cost of manufacture of byproducts?

A. Yes, sir.

Q. State to the Court, Mr. Webster, whether there is a difference, from the viewpoint of the accounting profession, the understanding and practice of that profession, between the [467] cost of production or the cost of manufacture of a main co-product, on the one hand, and a byproduct on the other?

A. Well, of course, various manufacturing processes result in various types of products and byproducts. In many cases there may be no byproducts whatever from a manufacturing operation, in which case obviously all costs are allocated to the main product, or if more than one product, more than one primary product is produced, the cost would be divided between the various joint products or co-products.

In other cases you may have byproducts which are produced as an incident to the manufacture of the primary product, and which perhaps may be salable at the point of separation without further processing. As, for example, the sawdust from a saw mill. The ordinary method of accounting for such a byproduct is that it is credited against the cost of production of the main product, although at times it may be credited to miscellaneous income. But there is rarely an occasion to determine the cost of such a byproduct.

(Testimony of Paul K. Webster.)

With regard to byproducts which are separated from the main product or from the product in process and which require further processing before they are salable, you may or may not determine the cost. In other words, you may without segregation determine the cost of the total process and still credit against that total process the proceeds from the sale of the byproduct. However, it is not unusual to determine the separate [468] cost of processing such a byproduct, and in such a case the ordinary method of determining the cost of the byproduct is to ascertain the amount of the costs which are directly and solely attributable to the manufacture of that byproduct and which are identifiable as such.

Q. When you say "identifiable as such," does that mean ascertainable as such?

A. Yes, substantially that, I should say. In other words, you attempt to determine the amount of the costs which you incur because of the production of that byproduct and which you would not incur if you did not produce the byproduct, and which you would presumably eliminate if you suspended the production of the byproduct.

Q. That is the general principle that, according to your understanding of your profession and accounting principles, would be good and proper practice?

A. That is correct.

Q. In the case of a situation where not only the manufacturer is concerned with, let us say, his cost of manufacture or the cost of production of

(Testimony of Paul K. Webster.)

a byproduct, but also in a situation where the purchaser of the byproduct, the product which requires and receives further processing to make it salable, such as where the purchaser's price for the product would be affected or increased by any actual increase or actual advance in the cost of production or cost of manufacture of the [469] byproduct, what would you say good accounting practice would be with reference to items of cost to be included in the cost of manufacture of such a byproduct?

Mr. Rosenberg: Just a moment. You are not relating that to any particular contract, are you, Mr. Bennett?

Mr. Bennett: I think I am entitled to state such a hypothetical situation, namely, the proper principles of accounting to be applicable not only in the case of manufacturing point of view but where the principles to be applied concerned a purchaser. The reason I make that point, Your Honor, it must be obvious that it might be conceivably not completely or absurdly bad practice for a manufacturer, if he wanted to determine, as against sales of the byproduct, the total cost of production, including the manufacturing, sales and other factors that might enter into it, to adopt certain procedures. But where we are concerned with a practice of accounting, the purpose of which is to determine the actual advance in costs of manufacture, may be—I haven't the witness' answer—that may be a different situation.

(Testimony of Paul K. Webster.)

The Court: Your question is rather involved. I would suggest that you reframe your question so I may follow the testimony.

Q. (By Mr. Bennett): Where the purpose of the accounting method is to determine the actual cost of production or the actual cost of manufacture of a byproduct where some other [470] person or concern, other than the manufacturer, would be affected by that cost of manufacture or cost of production, what would be, according to proper accounting principles, the items of cost that would be included in the cost of production or cost of manufacture.

Mr. Rosenberg: I submit, if the Court please if any accounting practices other than good and accepted accounting practices are to be followed by reason of a contract between the buyer and the seller, it could only be by virtue of what the contract contemplates and provides, and therefore for this witness to answer that question would require him in effect to state what the contractual arrangement was between the parties. Now, I understand this is purely objective.

Mr. Bennett: It is. I have stated a hypothetical case, Your Honor, and I think it is fairly proper to ask this witness. There may or may not be a rule applicable where only the manufacturer is concerned, but according to good accounting practices there may be a different rule applicable. I do not say that there is, but there may be greater reasons, for example, for that rule to be applicable

(Testimony of Paul K. Webster.)

where it is a matter of concern not only to the manufacturer but a matter of concern to the seller. We are dealing, mind you, not with the decision of this case but with this expert witness' opinion.

Q. (By the Court): May I ask you a question for my own information? When you speak of the cost of manufacture and speak of [471] the cost of production, what distinction would you make?

A. Practically none.

Mr. Bennett: I do not contend that there is any distinction.

The Court: That has been used and used repeatedly and I did not think there was any, so I wanted to clear it up. It is only for my own information.

Mr. Bennett: The reason I used that is that paragraph 6 at one point speaks of cost of production and in another place cost of manufacture.

The Court: I wanted to know if there was any distinction.

The Witness: I would say not.

The Court: Proceed.

Mr. Rosenberg: I will object to the question, if the Court please, on the ground it is incompetent, irrelevant and immaterial and unintelligible——

The Court: I am prepared to rule on the question. I think it is well to break it down. It is involved, and so I may follow the testimony definitely, I suggest that you reframe your question.

(Testimony of Paul K. Webster.)

Mr. Bennett: I will approach it in a different way, Your Honor.

Q. You stated, as I understand it, Mr. Webster, in determining the cost of production or the cost of manufacture of the byproduct, that type of byproduct that does not require any [472] further processing but has some value as soon as it is separated from the process of manufacturing the main product, the usual or common practice is simply to credit the proceeds from the sale of that byproduct against the cost of manufacture of the main product; in other words, from an accounting point of view, not to determine that there are any actual costs of manufacture of that type of a byproduct.

A. That is correct.

Q. On the other hand, the type of byproduct that requires after its separation in the process of manufacturing the main product or the primary product some further processing, such as the example of sawdust, the manufacture of sawdust into these Presto-O logs or little molded forms that are used for firewood, that in determining the cost of manufacture or the cost of production of that type of byproduct, only those costs which are directly and solely required or incurred in the manufacture of that byproduct from the point of separation and which are identifiable or ascertainable as such are used, is that correct?

The Court: Answer for the purpose of the record.

A. Yes, that is correct.

(Testimony of Paul K. Webster.)

Mr. Rosenberg: If you are undertaking to state the witness' testimony, I think the witness testified, Mr. Bennett, that in the case of a byproduct of that kind which requires further processing, you either may or may not determine its cost [473] of production.

Q. Isn't that what you said, Mr. Webster?

A. Yes, that is correct. You may or may not.

Q. (By Mr. Bennett): If you do not, you treat it just as you treat the other type of byproduct that is salable without further processing, is that correct? A. That is right.

Q. And in that case there would be no cost of production assessed against that?

A. That is correct.

Q. The other alternative, where you actually set up or seek to determine the cost of production, you consider what items of cost?

A. Those items which are directly applicable to the production of the byproduct and which would not be incurred if you did not produce the byproduct.

Q. You said something about also being ascertainable.

A. That is correct. Obviously from a practical standpoint you are trying to fix costs for the byproduct which can be determined with a degree of accuracy based on ordinary accounting methods.

Q. You would not include, as I understand it, items that are not directly ascertainable in both

(Testimony of Paul K. Webster.)

character and amount as being necessary for the production of that byproduct?

A. That is correct. [474]

Q. Can you be, to the aid of the Court, more specific, Mr. Webster, by example or illustration, if that is possible, of the type of costs that would be included in the cost of the production or manufacture of the byproduct?

A. Do you wish me to assume a certain type of byproduct or just any one?

Q. Let us start off with that situation we gave about the Prest-O logs, for example. I will withdraw that situation. Let us say, rather, the manufacturer has a plant where the purpose is to manufacture a primary product which we call magnesium oxide. This product is manufactured from a substance known as bittern water, which substance is sea water condensed by processes of evaporation and other processes, and after the salt is removed therefrom by, let us say, a salt company, the bittern water or the remainder after the salt is taken from it is purchased by this manufacturer and to this bittern water is added a chemical product known as calcium chloride, the effect of which is to form in bittern solution a chemical combination known as magnesium chloride, which chemical combination, magnesium chloride, is further processed by the addition of other chemicals, such as calcium hydroxide, and from that manufactured the primary product, magnesium oxide.

(Testimony of Paul K. Webster.)

But in that step of manufacture, after the addition of the calcium chloride to the bittern water, there is precipitated a chemical known as calcium sulphate. The process for the [475] manufacture of the primary product, magnesium oxide, requires the removal from the magnesium in the bittern water of the sulphate, which is also present in chemical form, and the calcium sulphate, which is precipitated in the process of manufacture, is necessary to be removed, in order to manufacture or to produce the primary product, magnesium oxide, but which product, calcium sulphate, at its point of separation from this fluid, which goes on for further processing in order to manufacture the primary product, requires drying, grinding and delivery to railroad cars in order to make it salable. Now, also on the assumption that that calcium sulphate, dried and ground, is known as gypsum and is also a byproduct—on these assumptions what would be the items that would be included, according to good accounting principles and according to your experience and opinion as to the cost or costs of production or manufacture of the byproduct gypsum.

A. I assume now for the purpose of this answer that the gypsum or the material which is withdrawn is in effect an impurity for purposes of the main product and would, without further processing, be valueless or substantially valueless at the point of separation. Consequently the problem is to determine the cost of putting that in salable form as

(Testimony of Paul K. Webster.)

against discarding it or throwing it away. Now, on the basis of those assumptions it seems to me that accepted accounting principles would require that for the purpose of determining the cost of the by-product [476] gypsum——

Q. The cost of production.

A. The cost of production of the byproduct gypsum, you ascertain the costs which are incurred solely because of the production of that gypsum as against the throwing away of the gypsum or of the product from which the gypsum is made. Now, those costs would obviously be labor in drying and grinding the product, in fuel or water or power that was used in the process, that is, the process related to the gypsum; other costs which are directly applicable, presumably including repairs to that machinery that is used in connection with the gypsum, reasonable allowance for depreciation of that machinery, possibly taxes and insurance on that part of the plant that was devoted to gypsum and any other costs which could be shown to be necessary to the production of gypsum and not necessary if gypsum were not to be produced. I might add that obviously a determination of that sort would be highly desirable not only from an accounting standpoint but also from a management standpoint in determining whether the gypsum should be processed and sold or whether it should be discarded. Obviously if it were to cost more to process it and to prepare it for sale and the principal

(Testimony of Paul K. Webster.)

proceeds, the obvious management decision would be to discard it rather than to process it. [477]

Q. State whether in the situation given you in direct charges which would have been incurred if no gypsum had been produced, that is processed by drying, grinding and delivery but in lesser and unascertainable amounts, would any of such costs or indirect charges of that character be properly included in the cost of production or manufacture of gypsum.

A. The question in my mind is not whether a charge is direct or indirect. The question is whether or not it is attributable solely to the production of the byproduct and whether the amount attributable to the production of the byproduct can be ascertained. In other words, what I am trying to say is that the cost considered as a part of the cost of producing the gypsum, in this case, whether they are classified on the books as overhead or direct, it seems to me, is unimportant as long as they are directly attributable to the manufacture of this product.

Now, it also seems to me that in ascertaining a cost of a byproduct only those costs should be included which are ascertainable.

In other words, if there is some type of indirect expense which might be affected to a minor degree by the elimination of the production of gypsum, but the expense of that further can not be measured or ascertained, then from a practical standpoint

(Testimony of Paul K. Webster.)

I would say that that should not be included in the cost of the gypsum.

Q. Would you say that any charges which would have been [478] incurred if no gypsum had been produced but in a lesser and unascertainable amount should be considered as cost of production of gypsum?

A. If I understand your question, I believe the answer would be no, because my point is you should be able to ascertain the amounts applicable to gypsum or else you should not charge it.

Q. Mr. Webster, I am going to hand you here a list of charges and purported costs which are set forth on Exhibit F to the defendant's interrogatories in question here, which is Plaintiff's Exhibit 15, under the title in two columns, the figures are in two columns, one for the period July 1, 1944, to July 30, 1945, and the other column is from July 1, 1945, to June 30, 1946, and I will ask you to go down the items under the subparagraph B of said exhibit F and tell the Court which of those items, in your opinion, are properly includable as cost of production or manufacture of the byproduct gypsum, and in this connection, I would like you to also refer in addition to the item which is listed on the lefthand column of the page with the comment which appears on the righthand column such as the first word "Allocated," underneath that, "Actual Time Card," and so forth.

A. The first item is supervision. I presume that means general supervision of the plant which is

(Testimony of Paul K. Webster.)

stated to be allocated. If the supervision should be—if a separate supervisor were required for the gypsum operation, that would be a proper charge. [479] However, the assumption from this item would seem to be that plant supervision cost and the cost of the plant superintendent would go on regardless of the gypsum produced. If that is the case, no charge should be made to the gypsum operation. If, however, the plant superintendent or others saw fit to keep records of the time devoted to gypsum to have their salary or salaries ascertained and charged on that basis, it would seem to me no objection to that charge if such determination were made.

Q. Pausing a minute, if the gypsum should be discontinued, that is the manufacture of gypsum stopped from this point of separation, and this item of supervision would continue on, even though it would continue in a less degree but an unascertainable degree, should or should it not be included in the cost of manufacture or the cost of production of gypsum?

A. Without further information than is indicated here, I would say the answer would be no.

Q. Take the next item.

A. Labor, operation, actual time card distribution, and it seems to be a direct charge related solely to gypsum operation and would seem to be includable.

Labor repairs, actual time card distribution. The same answer. Materials—operations, storeroom

(Testimony of Paul K. Webster.)

requisitions and direct purchases. Assuming that those are materials used in gypsum operations, they would seem to be a proper charge. [480]

Q. Would that be so if it were merely charged on a so-called allocating basis without—

A. No. The amount which they had—the direct materials used for the operation and accounted for as such. Materials-repairs, same answer if the repairs related to the gypsum operation, it would be entirely acceptable.

Bittern, arbitrary allocation. Well, it would seem to me that the purpose of using bittern as you have described it would be to produce the main product and not the byproduct and I would not be inclined to allocate any of the basic material costs to the byproduct.

The next item, sulphuric acid—

Q. Well, we will come to that and I will ask you a question later.

The Witness: Shall I proceed with the other items?

Q. Yes.

A. The next items, water, power, gas, fuel oil, all of which are stated, or are costs measured, would relate to the production of gypsum so they seem to be properly includable.

The next item is sulphuric acid. Incidentally, I might say in regard to fuel oil, in the early period there is no column in the account, column for the fuel oil and I think it should be brought out that the items included in these two periods should be

(Testimony of Paul K. Webster.)

based on the same method of accounting which may indicate a difference in the type of fuel used, in which [481] case it may be that the fuel oil was used in the earlier period and was not charged and if so, then certainly that should be taken into account in determining whether or not there is an increase in cost.

Q. Well, if fuel oil was used before and not charged against the product and then in the second comparative period it is charged, would that be in accordance with proper accounting practice where the purpose is to determine the relative costs for the two periods?

A. Definitely not. In other words, if you are attempting to ascertain increase or decrease in cost of production, your methods of accounting for the two basic periods under consideration should be the same.

Q. The next item, you say, is sulphuric acid.

A. Yes.

Q. Well, in the first period is there any charge for sulphuric acid?

A. No charge for sulphuric acid in the first one.

Q. The second period, there is a charge?

A. Yes.

Q. Would you say on the basis of your previous answer the same answer would be given?

A. Definitely.

Mr. Rosenberg: Wait, just a minute. I will object because the proper foundation has not been laid. There is [482] evidence in this record that

(Testimony of Paul K. Webster.)

during the prior period and, incidentally, in the hypothetical question that Mr. Bennett asked, he did not even mention the bromine process, and as far as this question is concerned, the evidence shows without contradiction that in the prior period during which there was no charge for sulphuric acid, the bromine towers were operating, in the second period they were not. I believe that should be included or the question would be entirely meaningless.

Mr. Bennett: I think that is something separate and apart. The witness stated in answer to counsel's point, that irrespective of physical factors where the purpose is to compare two periods to determine either increase or decrease, that the same accounting principles or system must apply. In other words, they cannot in the second period where an increase is claimed, add an item that was not contained in the previous period, if I understand the witness' testimony with respect to this so-called bittern.

The Witness: That is correct. It would seem to me that in this case there should be a charge for sulphuric acid in the first period if there is to be one in the second period. However, whether or not there should be one in the second period is another question on which I have not yet expressed a view.

Q. But whether or not there should be a charge in the second period, the period where an increase in cost is claimed, would it be proper to include

(Testimony of Paul K. Webster.)

there an item such as sulphuric [483] acid, which did not appear therein the previous period?

A. It would seem improper to me, based on my limited knowledge of the facts.

Q. Assuming, aside from your answers so far, that this sulphuric acid, is added to the bittern water or the solution from which the primary product, magnesium oxide, is to be produced, but prior to the separation of the calcium sulphate which is precipitated out the bittern in order to make magnesium oxide, the said calcium sulphate being the impurity that must be gotten rid of—

Mr. Rosenberg: You might as well say in—well, I object to that assumption in the question. There is no evidence in the record, as far as I know, that this sulphate is an impurity. Mr. Flick, who admittedly is not a chemist, used that term on a number of occasions, but it was agreed he was not qualified as a chemist.

Mr. Bennett: I thought the *witness* Rosenberg said that in his opening statement, he admitted the process shown on the chart here was substantially correct only it was an oversimplification.

Mr. Rosenberg: That's right.

Mr. Bennett: In other words, he did not correct at that time, Your Honor, that which the chart showed and what I commented upon about this calcium sulphate from which the gypsum is made being an impurity that has to be taken out of this [484] bittern water with the addition of this calcium chloride and we consider this sulphuric acid

(Testimony of Paul K. Webster.)

in order to make the end product, like the peach pit has to be taken from the peach before it can be canned.

Mr. Rosenberg: I never said anything of the kind.

Mr. Bennett: I thought you agreed. Anyway, I think I am entitled to such a hypothetical question even if I have to fill it in.

I will go back again in view of all this discussion and break my question up in two.

Q. Assuming, Mr. Webster, aside from the fact no charge is made for the sulphuric acid in the first of the two comparative periods that in the process of manufacture during the second comparative period that this sulphuric acid was added to the process in manufacture prior to the point of separation of the byproduct and is a step or part in the manufacture of the primary product, and then aside from the objection which you pointed out, is there any other objection or not as to the inclusion of sulphuric acid as a proper item of cost of manufacture or cost of producing the gypsum? A. Yes.

Mr. Rosenberg: Just a moment. I object. It assumes a fact not in evidence, that is that the sulphuric acid is necessary to produce the magnesium oxide. There is no evidence in this record.

Mr. Bennett: Well, I will strike out the part "necessary" or "desired" and ask the witness the same question on the assumption the sulphuric acid

(Testimony of Paul K. Webster.)

is added or employed in the process of manufacture and prior to the separation of the byproduct.

A. Well, if the sulphuric acid is used for the purpose of separating an impurity from the main stream of production and would be used regardless of whether the calcium sulphate were to be saved and sold, then it seems to me that the sulphuric acid is an identifiable part of the cost of the main product and not of the gypsum. However, if the sulphuric acid were added only because you intended to produce calcium sulphate or gypsum, you might conceivably get another answer.

Q. Will you describe the next item?

A. Next item is described as overhead, which is supposed to be allocated on a labor basis. On the basis of that information alone, it would appear nothing would be chargeable to gypsum. However, there may be items in there that would be chargeable to gypsum if they were identified and ascertained.

In other words, as I said before, the question of classification as to overhead on the process described to me on what I will call the hypothetical question, it is a question of whether the items considered to be costs are actually costs incurred——

The Court: Regardless of what they are labeled?

A. That's right. [486]

The Court: Taxes.

A. Taxes, insurance and depreciation, I think we can consider together although they are not entirely similar. Depreciation is includable as far as

(Testimony of Paul K. Webster.)

it affects the gypsum equipment or the gypsum plant. Taxes and insurance would be the same although some question could be raised as to those items. However, I think from a practical standpoint, it would be includable.

Inter-departmental charges at cost. I don't know what those are. I would hesitate to express an opinion without more information. It is a similar item, in any event.

Shipping expense—

Mr. Bennett: We pause a minute to go back to depreciation. Assuming that depreciation should be included, what should be included appropriately as to items of actual cost of manufacture of a by-product, depreciation of what?

A. Depreciation of the facilities which are used specifically for the processing of the gypsum.

Q. Is there any limitation or restriction as to how that depreciation should be determined?

A. Well, I think that is getting into something that is not strictly an accounting problem. There are several methods of determining depreciation. The one to be selected in a case like this would depend to a large degree on the circumstances.

Q. In a case where the purpose of the accountant is to determine increase or decrease in cost of production which would in [487] turn affect the price of the product to the purchaser and the price based upon a per ton factor, would any acceptable method of computation be applicable, or can you

(Testimony of Paul K. Webster.)

state a certain formula for determining the depreciation or rate of depreciation?

A. I should think the depreciation charge should be something in proportion to the production because you may have a situation where production is very low in one year and you get a very high per ton cost. If you have considered a straight line method of depreciation, it might not be a fair cost at all on a unit basis for production of gypsum.

Q. Would you say the so-called straight line basis of depreciation would be applicable in the hypothetical case I have given you?

A. Well, it would seem to be less desirable than a basis which would be in proportion to the production. I might point out here that that does not necessarily imply that the company in its own accounting must have a unit or production basis for depreciation. It is not at all uncommon for a company involved in the sale of a particular product to make separate computations of its costs for the purpose of the contracts which may be entirely different from the cost shown on the books. In other words, one accounting method might work if only the company's interest for their own use were concerned whereas in other instances other principles would be applicable where other parties were [488] affected, especially where there is a contract.

Q. Yes.

A. Shall I proceed with the other items?

Q. Yes. A. Shipping expense.

Q. Wait. What taxes are to be included in cost

(Testimony of Paul K. Webster.)

of production of byproducts? What tax and on what basis should the tax be included?

A. Well, there are several types of taxes that might be included.

The Court: Read that on the left side, 28 cents for actual cost—

The Witness: Actual cost plus pro rate of miscellaneous shipping expense.

The Court: What does that mean?

A. I presume there are some actual shipping expenses relating to gypsum and possibly some overhead expenses of the shipping department that are prorated on the same basis.

Mr. Bennett: I am coming to that point in a moment, Your Honor. I wanted to clear up this matter of the tax situation.

The Court: Pardon me. Proceed.

The Witness: Taxes of several kinds might be applicable here. For example, social security taxes representing the employees in the gypsum department would obviously be a direct [489] cost of the production of gypsum. Property taxes relating to the assets used in the production of gypsum.

Mr. Bennett: You mean by that the actual and only the actual facilities that are used in the processing of this byproduct, the grinding and drying?

A. Yes, that is correct.

Q. You expressed some question as to whether or not taxes should necessarily be included in the cost of production and manufacture of gypsum. Will you state the reason?

(Testimony of Paul K. Webster.)

A. Taxes are something tied up to your general cost of doing business rather than as a cost of a manufacturing process.

Q. In other words, there is a difference between general cost of doing business and in this manufacturing or production of a particular product?

A. Correct, but from a practical standpoint in a case like this if the tax applicable to this, if the property tax applicable to gypsum, if that was readily determinable, I would have no objection to including that.

Q. What would you say with reference to a system or plan of accounting that charged up as cost of production and manufacture on the books as taxes the prorated percentage of the total book assets of an entire plant portions of which were not used—Pardon me. Strike that question.

In connection with the tax situation and this property tax, if that were to be included in the cost of production, [490] would it be proper to allocate as a cost a certain figure which represents the percentage roughly calculated in relation to the value of a whole plant or could some other formula be employed in determining the tax cost or charge for the comparative periods under consideration?

A. Well, I would prefer not to use an allocation in a situation of this kind because it generally would be itself a statement where you have the valuation of the plant involved and apply the tax rate to that and you get an actual figure. How-

(Testimony of Paul K. Webster.)

there might be no serious objection to it. As long as you accomplish substantially the same figure that you have to accomplish and you get an applicable determination for the gypsum——

Q. Any arbitrary or unrelated method of allocating taxes if they are to be included would be improper. A. Yes, I would say so. [491]

Mr. Rosenberg: I object to that on the ground there is no foundation laid for that. Where is there any evidence of any arbitrary allocation of taxes?

Mr. Bennett: Counsel, I am trying to have the witness state his understanding of the proper principal of allocating tax costs that are to be included, and I think I can state hypothetical questions to him.

The Court: There is a differential here of 7 cents with relation to the items mentioned in this last exhibit referred to.

Mr. Bennett: It is not only the items we are objecting to, your Honor, but it is the method by which they are determined. I think we shall not have so much trouble with the items, once we decide and get established in this case what costs are to be allocated.

The Court: If I followed this witness' testimony, it might apply to either one. If I am in error about that, you correct me.

The Witness: Either one of which?

The Court: Methods in relation to taxes on real property.

(Testimony of Paul K. Webster.)

The Witness: Yes, it would be preferable to have a direct determination, but an allocation on a basis that would arrive at substantially the same result might be acceptable.

Mr. Bennett: Yes, Your Honor, but the witness also stated that on an allocable basis it has to bear relation to values, that is, the value of the particular property that is being used for gypsum in its relation to the value of the whole plant. [492]

The Court: I understand that.

Mr. Bennett: There can't be any arbitrary——

The Court: Counsel objects to your using the word “arbitrary,” for there hasn't been any evidence, as he contends, that there has been any arbitrary method used.

Mr. Rosenberg: That is right.

Mr. Bennett: Let me say this, your Honor: In their answers to the interrogatories they say the taxes have been roughly allocated. Now, “roughly allocated” was not what the witness said should be done, as I understood his testimony.

The Court: If you can clear that up in any fashion it is all right with me.

Mr. Rosenberg: The only evidence before the court is what is contained in there. It says it is allocated on the basis of plant value.

The Witness: Roughly based on plain value.

Q. (By Mr. Bennett): Is that rough allocation proper?

A. I think it should be sufficiently accurately done so that you will arrive at substantially the

(Testimony of Paul K. Webster.)

same figure that you would have arrived at had you determined the valuation and the tax rate applicable to that specific equipment.

Q. State whether or not you consider as proper a rough allocation of taxes?

A. Not for the purpose of what we have involved here.

Mr. Bennett: Does that clear the matter up, your Honor, on [493] that point?

The Court: It is as clear now to me as it was in the very beginning.

Mr. Bennett: Then your Honor has a better understanding that I did.

The Court: I will say I have a better understanding of these commonplaces.

Mr. Bennett: I was not criticizing your Honor. That was perhaps a little side remark that I made in all respect to your Honor. Your Honor had really seen the point, perhaps, without my going into it.

The Court: While I have not gotten into the chemical or accounting fields to any degree, I have heard experts for years testifying, and that might be helpful to me in my appraisal of what this testimony spells out. Now, proceed, gentlemen.

The Witness: Shipping expenses is the last item, and shipping expenses, as I would interpret it, might not specifically relate to cost of production, or cost of manufacture.

Q. (By the Court): The contract would probably take care of that, shouldn't it?

(Testimony of Paul K. Webster.)

A. It seems to me it should.

Q. (By Mr. Bennett): Actual, so-called direct shipping expenses would be included or not included in cost of manufacture?

A. Well, as such, hardly in cost of manufacture, although they might be appropriate charges in determining the cost. [494]

Q. They would not strictly be cost of manufacture? A. No.

Q. Assuming, though, that they could be or would be considered cost of manufacture, should there be any shipping expenses charged that are simply allocated but which cannot be ascertained as directly required in the handling of gypsum?

A. No, I think you would apply the same principle there as you would to other indirect items, that you should charge them only to the extent that you can directly associate them with the production or shipping of gypsum.

Q. Assuming that a manufacturer had, according to his own system of accounting, a shipping clerk take care of shipping for the whole concern, the operation of the whole plant, including the primary product produced, and in the event the by-product gypsum was no longer produced, they no longer processed it for sale, and that production of gypsum was shut down, his employment would go on the same way as before, that is, they would have his salary as the shipping clerk: Would any part of his salary, even assuming that shipping ex-

(Testimony of Paul K. Webster.)

penses were a cost of production, be chargeable against the cost of manufacture of gypsum?

A. I would think not.

Q. Take the case of the accounting department, where they have, say, two clerks or three clerks handling all the accounting detail, sales invoices, all of the records that went on, the general accounting for the plant, and in the event the by-product [495] was no longer produced, or its production stopped, that accounting department would still go on, even though the work would be to a less degree by reason of the stoppage of manufacture of gypsum, but in an ascertainable degree: Would it be proper to allocate any portion of that accounting office or charges to the cost of manufacture of gypsum? A. I would say no.

Mr. Bennett: You may take the witness.

The Court: It is time for adjournment.

(Thereupon an adjournment was taken until tomorrow, Wednesday, December 17, 1947, at ten o'clock a.m.) [496]

Wednesday, December 17, 1947, 10 o'clock a. m.

The Clerk: Pacific Portland Cement Company vs. Westvaco.

PAUL K. WEBSTER,
resumed the stand.

The Court: You may proceed now, Counsel.

Cross-Examination

Q. (Mr. Rosenberg): Mr. Webster, have you

(Testimony of Paul K. Webster.)

ever visited the plant at the Westvaco Chlorine Products Company at Newark, California?

A. No, I have not.

Q. So the only knowledge that you have of the operation at the plant is what you have gleaned from the questions that have been put to you by Mr. Bennett, is that it?

A. That is correct.

Q. And the assumptions that he asked you to indulge in in the questions that he put to you, is that it?

A. I would say that is correct.

Q. And, of course, the opinions that you expressed in response to questions which asked you to assume certain facts were influenced by the facts which you assumed in giving your answers?

A. Oh, definitely.

Q. This is true, is it, Mr. Webster, as a certified public accountant, if you were called upon by the Westvaco Chlorine [497] Products Corporation to set up their cost accounting for them, before you could determine the proper methods and accounting principles to be employed in the cost accounting of gypsum, you would have to go over to the plant and make a thorough study of their processing operations, would you?

A. That is correct.

Q. And you would have to know something about the origin of the plant, would you?

A. Probably.

(Testimony of Paul K. Webster.)

Q. So you are not in a position to state as a fact whether gypsum is a product which by its nature should be considered for accounting purposes as a by-product or a co-product, is that true?

A. That is correct. I have not visited the plant. I do not know what the processes are.

Q. Let me ask you this: You have testified in the abstract that a by-product is to be treated for accounting purposes different than a joint product or a co-product, is that right?

A. That is correct.

Q. How do you define a by-product in that sense?

Mr. Bennett: Of course, your Honor, again I raise the objection that I have heretofore, that the contract in this case specifically states that this is a by-product. Gypsum, the product with which we are dealing, is a by-product and that therefore the defendant is estopped to deny in this proceeding, or otherwise, so far as any right or obligation of the plaintiff is concerned, the fact is so far as the application of the contract is concerned, that this so-called escalator clause, paragraph 6 of the contract, or the price to be paid under that or other clauses of the contract, should be based on any other consideration than the fact that the product covered by the contract is a by-product.

The Court: We are discussing here the proper method of allocating cost.

Mr. Bennett: Yes.

The Court: And to exclude and just limit the testimony to one phase of the case, how am I to

(Testimony of Paul K. Webster.)

determine what is the proper method of allocating the cost of these products, or any of them?

Mr. Bennett: The point I make, your Honor, is the contract binds the parties and the court, in so far as determining what character of product it is, that it is a by-product because the parties have agreed by contract that it is. Now, this question is designed, as I take it, only for the purpose of attempting to show that this product was perhaps something other than a by-product.

The Court: Keep in mind the examination you went into with your own witness with relation to co-products.

Mr. Bennett: That was opened up, your Honor, merely for the purpose of showing the different methods of accounting [499] that applied to a co-product and the method that applies to a by-product, but I did not open up and, as your Honor recalls, I strenuously objected to any attempt by the defendant in this case to prove or to establish the fact that this product was something other than a by-product, because I have always maintained, as your Honor recalls, from the start of this case, that the contract, by agreement of the parties, established this product as a by-product. Therefore, it is not proper for the defendant to dispute the character of product or attempt to show to this court that, in fact, it is something other than a by-product. That is the only point I make, and that was my assumption, that the purpose of this question was to attempt to establish by the cross-exam-

(Testimony of Paul K. Webster.)

ination of this witness that in fact this gypsum was not a by-product but is, in fact, a main or a co-product.

The Court: For the purpose of the record, you may indicate the purpose of the offer.

Mr. Rosenberg: I think I have stated on a number of occasions, and the court has so ruled, that it is true in chemistry or in the vernacular of the chemical industry, this may be a by-product, but this witness is testifying as to the treatment of the product in the accounting field, and the term may have an entirely different meaning in accounting practice than it has in the chemical industry.

The Court: For that limited purpose, I will allow it. [500] The objection is overruled.

Q. (Mr. Rosenberg): Will you tell me, Mr. Webster, how you define a by-product as the term is used in accounting practice to distinguish between a by-product and a joint product or a co-product?

Mr. Bennett: May my objection run to this line of questions?

The Court: Very well. Let the record so show.

A. An exact definition of a by-product is a little difficult because the term "by-product" is used to refer to a rather wide variety of products. Generally, however, a by-product is produced as an incident to the production of some other product or products, which are usually referred to as the main product or perhaps joint products. The by-product comes off during the process as an

(Testimony of Paul K. Webster.)

automatic thing almost; again, such as sawdust in a sawmill. You have to produce the by-product to produce the main product. The by-product may be immediately salable or it may at the point of separation be a waste material which requires further processing in order to make it salable, but basically, it is a product which is produced as an incident to the production of something else.

Q. (Mr. Rosenberg): Do I understand by that that for accounting purposes your opinions are influenced by the assumption that the amount of gypsum that is produced is incidental to and dependant upon the quantity of magnesium oxide that is produced? [501]

Mr. Bennett: Just a moment. In addition to the other objection I wish to state to the court that this question assumes facts not in evidence. My questions to the witness were based on the hypothesis that gypsum was a by-product. Now, obviously he based his testimony, so far as accounting in this situation is concerned, on the assumption that it was a by-product, because my questions laid that predicate.

The Court: Read the question.

(Question read.)

The Court: The objection is overruled. He may answer.

A. I think quantity would not be basic there. In other words, the volume of the by-product would not be a controlling factor.

Q. (Mr. Rosenberg): My point is this: Whether

(Testimony of Paul K. Webster.)

or not the opinions that you have expressed as to the treatment of gypsum as a by-product are premised upon the assumption that the gypsum is produced incidental to the production of magnesium oxide?

A. Yes, I think that is a fair statement.

Q. So that therefore the amount of gypsum that is produced, whether it is or is not produced would depend upon whether or not magnesium oxide is being produced?

A. I do not quite understand that.

Q. In other words, your assumption is that gypsum is produced incidental to the production of magnesium oxide?

A. That is correct.

Q. So that it would follow from that, wouldn't it, whether or not gypsum is produced would depend upon and to the extent that magnesium oxide is being produced.

A. I can't answer that. I do not know.

Q. You can't state that. Will you concede this, Mr. Webster, that there is a school of thought in accounting circles who feel that if you are going to determine the cost of producing a by-product you should employ the same principles and practices as you employ in determining the cost of a joint product or a co-product?

A. I will concede that you can find so-called authorities which give a large number of different methods of accounting for by-products, the most common of which is not to account for the cost of by-products at all.

(Testimony of Paul K. Webster.)

Q. That is right.

A. The second of which is to account for by-products separately on some basis or other, of which there may be several variations, which have to be adapted to some degree to the problem at hand.

Q. In other words, you do not want the court to understand that the recommendation that you made or the opinions that you expressed are uniformly accepted in accounting circles? There are some people, are there not, in accounting circles, and reputable authorities who think that if you are going to determine cost of producing a by-product you should apply the same principles [503] and accounting methods as you do in the case of a joint product?

A. I think that that depends on the circumstances. The authorities would not say that in all cases you should apply any one method to accounting for by-products. In other words, you have to consider all the circumstances and adapt your accounting methods to the circumstances of the individual case.

Q. It is true, then, in certain circumstances good accounting practice would permit the determination of cost of producing a by-product in the same manner as the determination of the cost of a joint product or a co-product?

A. Yes, although I suspect that that is true only in cases where the so-called by-product is perhaps in fact a co-product or a joint product. In other

(Testimony of Paul K. Webster.)

words, where you are approaching a factual situation that justifies similar treatment for a by-product to what you have for a co-product.

Q. Can you conceive of this, Mr. Webster, that in a chemical operation such as this, where you start with this bittern and you are putting it through three departments, so to speak, where you recover bromine in one department, gypsum in another department, and magnesia in another department, that they might very properly be considered co-products for accounting purposes?

A. That is a possibility, I would say.

Q. I believe you stated also that even in cases where the by-processing or refinement to make it a commercial product, under certain circumstances it is good accounting practice [504] not to even determine any cost of the expense involved in processing and refining after the point of separation, isn't that true?

Mr. Bennett: Just a moment. May I have that question read?

(Question read.)

A. Yes, that would be true in cases where you credit the entire proceeds against the cost of the main product, and perhaps make no separation of the cost of the by-product from the main product. That is a method which is sometimes used.

Q. So in those cases the direct labor and other expenses performed after the point of separation are merely considered as cost of the main product?

(Testimony of Paul K. Webster.)

A. Well, as a part of the total cost, not the cost of the main product necessarily.

Q. Let us see if I understood your testimony yesterday: Do I understand you to say that in your opinion, in determining the cost of producing a by-product, it is improper to include any overhead expense or any indirect charges, the precise amount of which attributable to the processing of the by-product cannot be determined?

A. Well, I think I did not use the word "precise." However, generally you stated my position and under certain assumed conditions.

Q. Under certain assumed conditions. Of course, that is not true as to a joint product or a co-product, is it? [505] A. No.

Q. In other words, in the case of a joint product or a co-product there are certain expenses where you are producing more than one product which you know contribute to the production of the various products, but you can't, as a matter of accounting, say accurately how much for each product? A. Yes, that is correct.

Q. So those expenses—is it proper to term them indirect expenses?

A. Oh, that is a question of the individual method of accounting. I think it will suffice for this purpose.

Q. So those indirect expenses you allocate between the various products you are making, co-products or joint products, on some rational basis, is that correct?

(Testimony of Paul K. Webster.)

A. That is correct. I should like to extend that answer a bit, though, to point out the reason for that is that you are in business to produce several products, and your cost should be allocated on some equitable basis among those products. In the case of a by-product, however, you may or may not recover the by-product, and consequently you are justified, in my opinion, in applying somewhat different principles to determine whether or not you should recover that by-product at all, by avoiding charging to the by-product expenses which would go on regardless of whether you produced the by-product.

Q. But getting back to this apportionment now, you have to [506] allocate among co-products or joint products on some rational basis, is that right?

A. That is an accepted method.

Q. In other words, that is an accounting expediency, you might say, because you can't state with accuracy how much of this indirect expense actually contributed an amount to each product, so you have to adopt some rational basis of allocating, is that right.

A. That is right.

Q. And there is a variety of methods employed in good accounting for allocation of those indirect expenses, is there?

A. Yes, but I would not consider it good accounting unless the method of allocation bore some resemblance to a proper allocation based upon the circumstances.

Q. Yes, and in accounting you use different

(Testimony of Paul K. Webster.)

media according to circumstances and what the accountant in his good judgment thinks is the best method to approximate the actual?

A. That is right.

Q. It might be labor, it might be value, is that right?

A. That is right.

Q. It might be volume?

A. Right, and it might be different bases in the same operation, as a method of allocating different items of cost.

Mr. Bennett: We are still talking about co-products and joint products? [507]

Mr. Rosenberg: That is right.

Mr. Bennett: As distinguished from by-products.

Q. (Mr. Rosenberg): Assume, Mr. Webster, you have a plant such as the Westvaco plant at Newark, and you start with this sea water from which the Leslie Salt Company has taken salt. Was that process explained to you?

A. Yes, I understand generally.

Q. And we call that bittern after the salt has been taken out. Would you, in the light of the definition that you gave of a by-product, be willing to assume that this bittern is in itself a by-product of the Leslie Salt operations?

Mr. Bennett: I submit that that is wholly immaterial.

The Court: I was turning that over in my mind. I want that answer. You may answer it.

A. I haven't enough information about the

(Testimony of Paul K. Webster.)

process to know. It might be a by-product to the manufacture of salt. On the other hand, it might not be.

Q. (Mr. Rosenberg): So you think it is a reasonable assumption that the primary purpose that the Leslie Salt Company has in mind is to get salt?

A. Yes, but it might not be economical for them to produce the salt unless they sell the bittern.

Q. And that would be equally true in this plant, wouldn't it? It might not be economically feasible to produce the magnesium oxide without recovering something from the gypsum, isn't that [508] true?

A. That is a possibility.

Q. You do not know what the fact is in that regard?

A. I do not, no.

Q. Just assuming this plant—and we start with this bittern—was this magnesium process explained to you that precedes the gypsum process and the magnesia process?

A. Only in a general way.

Mr. Kaapeke: You mean bromine.

Mr. Rosenberg: I am sorry. I mean bromine.

Q. (The Court): You were in the courtroom when they were examining in relation to this chart?

A. From time to time.

Q. Are you familiar with the chart now?

A. Generally so.

The Court: Proceed.

Mr. Bennett: Your Honor, for the record I wonder if he should not identify this chart with some designation.

(Testimony of Paul K. Webster.)

The Court: Very well.

Mr. Rosenberg: This chart is not in evidence.

Mr. Bennett: I would like to have it admitted for identification at this time.

Mr. Rosenberg: I would certainly object to that going in evidence because, as I stated before, it is not accurate, and it is not complete.

Mr. Bennett: Counsel, I am asking for it to be identified. [509]

Mr. Rosenberg: That is all right.

Mr. Bennett: Marked as an exhibit for identification, because both you and I have referred to this chart from time to time.

The Court: Let it be admitted and marked for purposes of identification.

(The chart referred to was thereupon marked Plaintiff's Exhibit 16 For Identification.)

Q. (Mr. Rosenberg): Now, in the course of your examination, Mr. Webster, Mr. Bennett referred to indirect charges which would have been incurred if no gypsum had been produced but in lesser and unascertainable amounts, and I believe you expressed the opinion that in determining cost of production that such indirect charges should be excluded; is that right?

A. Well, that was—the point there is that here you have a by-product, or we are discussing a by-product which might or might not be saved and sold. Accordingly, it seems to me that you are justified in determining the cost of a product on the basis of the items that you can identify and ascer-

(Testimony of Paul K. Webster.)

tain as being directly related to the saving and selling of that product, as compared to discarding it. It is my contention that in most cases if you have items of the type that are referred to there they may be identified and considered direct charges into somewhat nebulous overhead items or indirect items, which is perhaps somewhat partially applicable to the by-product. [510]

Q. You are not speaking of indirect charges as being nebulous merely because as between different products you have to allocate them on a somewhat rational basis, you would not call that nebulous?

A. No; merely because it is applicable to by-product it is nebulous.

Q. That all depends on what you are talking about? A. Yes.

Q. What I am trying to find out is whether or not you would state as an expert that any charge that has to be allocated for inclusion in cost of production of a by-product merely by virtue of the fact that the amount has to be determined upon some reasonable method of allocation——

A. Well, I would say it is objectionable but not necessarily totally excludable. It would depend on the circumstances.

Q. Let's go back to the shipping department. Assume you have a shipping department where you are shipping several products, and we may assume for the moment that one of them is a by-product, and that you keep accurate records of the direct labor and expense in the shipment of those

(Testimony of Paul K. Webster.)

various articles, including the by-product, but in addition to that you have a shipping foreman, superintendent, an assistant shipping foreman or an assistant general supervisory employee or employees who are essential to the proper operation of that shipping department, and they actually handle all three products, [511] including the by-product; is it your considered expert opinion that merely because you would have to determine the amount of that labor reasonably attributable to the by-product by some method, some reasonable method of allocation, that the charge is objectionable for that reason?

A. Well, there are a number of angles to that question. In the first place, you have the question as to whether those shipping expenses, any shipping expenses——

Q. I am asking you to assume——

A. In the second place, there is a question as to whether these so-called indirect items would be reduced if you did not have the by-product.

Mr. Bennett: We are getting into a very complicated picture here that is not germane to the issue in this case. The question is very complicated and, besides, no matter how able a witness is he cannot——

Mr. Rosenberg: Mr. Bennett, if he does not understand it I am sure he will tell me. I don't want to be unfair with the witness and I am sure he is trying to be fair with me.

Mr. Bennett: Your question is complex.

(Testimony of Paul K. Webster.)

The Court: Let us proceed, gentlemen. For the purpose of the record, the court is now prepared to rule. The objection will be overruled. Proceed. Because this contract happens to represent a by-product does not exclude methods of allocating cost under the case here presented. I have indicated that now for the purpose of the record. Now we will proceed.

Mr. Bennett: I am not quite clear as to the court's remarks.

The Court: Proceed.

Mr. Rosenberg: Do you understand my question?

Mr. Bennett: I wanted the reporter to read the remarks made by the court.

Mr. Rosenberg: I think the court said merely because the contract states what is a by-product it does not exclude the evidence that is being elicited from the witness.

The Court: That is exactly what I said. I said more. I said I was going to allow the widest latitude. This is a field of experting accounting and it will be helpful to have the record disclose as much assistance as this court can get. For that reason I am going to allow this testimony.

Mr. Bennett: Your Honor understands my objection is as to the form of the question, that it was complex——

The Court: If there is anything complex——Is there anything complex about the question?

The Witness: I think I understand the question.

(Testimony of Paul K. Webster.)

The Court: He says he understands the question.

Mr. Bennett: All right, if he understands it.

Mr. Rosenberg: Do you remember the question?

The Witness: I would rather have you restate it.

The Court: Reframe your question.

Q. (Mr. Rosenberg): Mr. Webster, I believe that the question [513] that I asked you is this: That is it your position and your expert opinion that where you have a shipping department that is shipping out a number of different products, one of which is a by-product, and as a necessary expense to the operation of that shipping department you have supervisory employees, such as a foreman or an assistant foreman and a shipping clerk, we will say who is not supervisory but who performs general service in relation to the various products, including the by-product: Is it your expert opinion that because you would have to determine the amount of those expenses incident to the shipment of the by-product by some method of allocation, that it would be improper in determining the cost of shipping expense for the by-product to include any proportion of any general service or indirect charges if we may call them such?

A. I would not consider it improper if it can be shown that a portion of those expenses were incurred merely because of the shipment of the by-product.

Q. Why do you distinguish there, let us assume we are only shipping two products, one is a major

(Testimony of Paul K. Webster.)

product and one is a by-product. Let us assume that the volume or the quantity of the by-product is equal to the volume or the quantity of the main product.

Mr. Bennett: Just a moment. To keep the record straight, I think my previous objection about this being improper cross-examination—the parties are bound by the definition in the [514] contract—will run to this line of questioning?

The Court: Let the record so show.

Mr. Rosenberg: Do you understand the question, or did I get a chance to complete it?

The Witness: Yes, I understand it.

The Court: Where there are two products.

A. That's right. My answer would be that if the volume of the by-product were so large as to constitute a major portion or substantial portion of the shipping department expense, and it should not be possible to figure direct charges specifically to the by-product, and a very substantial amount of it can be shown under the expense of the department were largely cost of the shipping of the by-product, then I would say to that extent that the expenses were attributable to the by-product and should be so accounted for.

Q. (Mr. Rosenberg): Are you talking about direct charges where if we charged that——

A. I don't care so much what the method of accounting is. I am talking about charges that are attributable to the by-product, or the operation.

Q. For our purposes, assume in a chemical plant

(Testimony of Paul K. Webster.)

they are shipping two products, one of which is a main product and one a by-product. and assume also that as far as direct labor that is employed in the shipment of those two products accurate time card records are kept, and that labor is charged directly, and [515] in addition you have a shipping clerk, a shipping assistant foreman that divide their time without keeping accurate record of it between the shipments of the two products, and assume further that the quantity or volume of the two products is approximately equal, would you say that in addition to the direct charges directly attributable to the by-product that it would be improper to charge also a portion of the indirect charges, so to speak, of the superintendent and the shipping clerk?

A. I wouldn't say it would be improper under those basic assumptions as a method. However, the way I should prefer this to ascertain whether or not you should save and sell a by-product as compared to discarding it at some point in the process, and you would then charge against the by-product only those expenses which you would not have if you did not save and sell the by-product.

Q. Mr. Webster, if you were going to determine as a practical matter in a chemical plant whether it was economical to save and sell a by-product you would take into consideration all expenses that are incident to processing and the sale of that by-product, wouldn't you?

A. Yes.

(Testimony of Paul K. Webster.)

Q. That is something which is a matter of accounting and is impossible to ascertain accurately.

A. In minor cases perhaps, yes; generally, I think not.

Q. Well, let's forget about by-products, for the moment, and [516] say you had a plant that is producing 10 co-products, and you are trying to determine how much your expense, your general overhead and your indirect charges will decrease if you discontinue one of those products. That is something that is a practical impossibility from an accounting viewpoint, is it?

A. I think not.

Q. Surely, with accuracy.

A. Well, in minor respects, yes, but in major items, no.

Q. What do you call major items and what do you call minor items? Let's take a concrete example, I believe you have conceded that in the case of a co-product general and administrative expense is a proper item to include in determining cost of production, have you not?

A. No, I have not.

Q. You have not.

A. It is something done, but it is not always done.

Q. It is good accounting practice——

A. Well, generally your administrative expense is such a broad term, I think there is a definite method as to the subject of general and administrative expense.

(Testimony of Paul K. Webster.)

Q. All right, I will be more specific. Say you had a plant that is producing 10 products, all joint products, and you have got a plant superintendent and an assistant superintendent, and you are trying to decide whether you are going to discontinue the production of one of those ten products. You can't tell [517] me how much of the expense of the shipping plant, say, will be decreased by the elimination of that one product, can you?

A. That would depend upon the circumstances. In some cases you might.

Q. As a general rule it would be impossible to determine, wouldn't it?

A. If one were a minor product you probably could; if it were a major product, I think you could make a pretty good estimate.

Q. In other words, you feel as an accountant you could tell if you were going to discontinue one of ten equally main products, do you, you could tell your general and administrative expense would come down as a result of that?

A. I would say you could make a pretty good estimate.

Q. You could make an estimate, but it would be unascertainable from an accounting point of view?

A. Precisely, yes.

Q. That is the language that is used in here, that is typical of the type of expense that would probably continue but in somewhat lesser and unascertainable amounts?

Mr. Bennett: Just a minute. Let's keep the record straight.

(Testimony of Paul K. Webster.)

Mr. Rosenberg: I am talking about——

Mr. Bennett: Your question said, “That is the language used here.”

Mr. Rosenberg: The language that you read to the witness:

The Court: We will take a recess.

(Recess.) [518]

Q. (Mr. Rosenberg): Mr. Webster, to go back to shipping, would this be true, that assuming gypsum is a by-product, if you had a separate shipping department and in that shipping department you had a foreman and an assistant foreman and a shipping clerk and they devoted their time exclusively to the shipment of gypsum, you would not question the propriety of including the expense of those employees in determining the shipping expense of the gypsum, would you?

A. No, because under those circumstances the items would both be ascertainable and directly applicable to the product.

Q. Going back to the assumption of co-products again, if you had, we will say, three products being shipped out of the shipping department, you would include in the shipping expense for those three products some proportionate share for each product of the supervisory employees, making your allocation on some rational basis, would you?

A. That would be a proper method if you accounted for shipping expenses that way.

Q. Let us take another example of this type of expense. Let us take laboratory and assume that

(Testimony of Paul K. Webster.)

at the Westvaco plant at Newark a laboratory is conducted for the purpose of testing and analyzing samples of the various products that are produced at the plant, including gypsum, and as to gypsum, for the purpose of testing the product to see that it comes up to the specifications of a contract governing the sale of the product: would [519] you say that it would be improper to include in the cost of producing gypsum a reasonable proportion of the expense of the laboratory in which these services are performed for gypsum?

A. Speaking of gypsum now as a by-product?

Q. Yes.

A. I would say that it should not be charged to the by-product unless it was ascertainable in amount and definitely attributable to the by-product.

Q. But if you have a number of co-products your opinion would be different, would it?

A. That is correct.

Q. And if you keep accurate time records of the time devoted to each of the products which are tested and analyzed and worked on in the laboratory, including gypsum, and again assuming that it is a by-product, then you have certain indirect expense such as a superintendent chemist who has supervision of the laboratory and you allocate the expense of his salary between the various products, including gypsum, in proportion that the direct labor charges attributable to each product bear to the whole, would you say that that would not be a proper accounting practice?

(Testimony of Paul K. Webster.)

Mr. Bennett: In a by-product?

Mr. Rosenberg: I have said that, Mr. Bennett.

Mr. Bennett: Thank you.

A. Well, we go back to the same standard, keeping in mind, as [520] we already have said, there are several possible methods of accounting, but the standard by which I am inclined to judge the problem we have before us is whether or not the charge is ascertainable and directly and solely attributable to the production of the by-product, and under the circumstances which you have mentioned I would say that the direct laboratory expenses were definitely attributable to gypsum, if the accounts were so kept, that the overhead expenses which would go on anyway, regardless of the production of gypsum, would be very questionable and should not be charged unless they can be ascertained.

Q. Where you stated there were several different methods, then I assume you will agree that some other good accountant might have a contrary opinion and might feel that those indirect expenses should be included, is that true?

A. We have already pointed out that there are numerous methods referred to in texts on account for by-products, but that the important thing is to adopt the one which seems suitable in the individual case.

Q. So that some other reputable certified public accountant might hold a view that is contrary to yours, isn't that true?

A. I would consider that a possibility, certainly.

(Testimony of Paul K. Webster.)

Q. There are text writers and persons who have written treatises on the subject who hold to the opinion that in the case of a by-product which requires processing for the purpose of [521] making it a commercial product, you should determine the cost of production in the same manner as you would determine the cost of production for a co-product, isn't that true?

A. Well, as I have already stated, I think that those methods are applicable only when your product actually is not a by-product at all but actually is a co-product.

Q. Well, it is very difficult to distinguish and determine in a particular case what is a true by-product and what is not for accounting purposes, isn't it, Mr. Webster?

A. Well, there must be borderline cases. There are some cases where it is not difficult at all to distinguish and there are others where it may become difficult to distinguish.

Q. And in a chemical plant where you start with this bittern water and recover from it first bromine and then in another process you recover gypsum and then in another process you recover magnesia, it is conceivable that for accounting purposes those could all be treated as co-products, isn't it?

A. I can hardly answer that question based on the limited information I have about the processes and the products. It is conceivable that that could be true. Whether it is true or not, I do not know.

(Testimony of Paul K. Webster.)

Q. I believe your attention was directed to this exhibit F and the defendant's answers to plaintiff's interrogatories. I think your attention was directed to the item fuel oil, and your commented on the fact that it appears that in the period [522] 1945-1946 there was a charge of 1 per cent per ton and at a preceding period there was no charge, and I believe—and if I am incorrect, please correct me—that you stated that you would deduce from that that there had been some change in accounting methods in the two periods, is that right?

A. No, no, what I mean to say was there might have been a change in the nature of fuel used in the process but there might have been a change in accounting method. It could be the result of either.

Q. Let us assume, Mr. Webster, that that charge in the second period did not occur in the first period and did occur in the second period by reason of circumstances beyond the control of the producer. Then that would be an increase in cost to the producer, wouldn't it?

A. Let me assume some circumstances in answering that question. Assume that the ordinary fuel was natural gas, that the natural gas was not available during the second period but had been available during the first period. If it had been necessary for them to use fuel oil instead of gas in the second period, presumably that would be an addition to their costs for that period. Whether it would be an addition to the cost properly allowable under this contract might be subject to question——

(Testimony of Paul K. Webster.)

Q. No. Pardon me.

A. —because of the fact that it might be necessary for comparative purposes to assume some similar charge in the first [523] period in order to avoid distortion of the comparison.

Q. But from a strictly accounting viewpoint you would say, then, that the cost of production in the second period increased as compared to the first period, whether or not it is an increase that would be allowable under the contract?

A. Yes, If it costs them more to use fuel oil than it would have cost them to use gas, if that was not available, that would be true.

Q. Would you say this as an accountant, and being abstract again, that any new expense and additional expense that arises in the course of the manufacture of the product by reason of a change in circumstances that did not exist in a prior period would, as a matter of accounting, represent an increase in cost of production in the second period as compared to the first period?

A. You are speaking now of a cost of production of the by-product?

Q. Yes.

A. Then I would say yes. If the cost were directly attributable to the by-product.

Q. Yes. In other words, if it is a cost which in your opinion is a proper cost to be included in determining the cost of producing the by-product.

A. Yes, that seems a correct statement.

Q. In your testimony yesterday regarding taxes,

(Testimony of Paul K. Webster.)

I think there [524] is an error in the transcript and I would like to give you an opportunity to correct your answer.

Mr. Bennett: What page?

Mr. Rosenberg: Page 491, line 10.

Q. Speaking of taxes, you stated, "However, if the allocation were on the basis of value, there might be a serious objection to it," and I believe your testimony was "there might be no serious objection to it," isn't that correct? A. That is correct.

Mr. Rosenberg: We may consider the transcript corrected, may we, Mr. Bennett?

Mr. Bennett: Yes, and I might say I think we both agree there are numerous other corrections that we will make in due time, counsel.

Mr. Rosenberg: Yes.

Q. As far as taxes are concerned, where you have a chemical plant where there are various units in this plant for tax purposes, they are assessed as a whole ordinarily, are they not, Mr. Webster?

A. I could not answer as to the procedures that an assessor would use in that situation. It might be assessed as a whole. Frequently they are assessed by reference to individual items in the plant and I think a breakdown could be obtained from the assessor if it were requested.

Q. Let us say property taxes are assessed on the plant as a [525] unit, and assume also that it is possible to segregate the entire plant and divide it into separate units, exclusively devoted to the

(Testimony of Paul K. Webster.)

production of separate products, and having done so, that you allocate the total tax between the several units in the relation that the plant values of the separate plants bear to each other. Do you believe that that might result in a reasonably accurate result?

A. Probably more information would be necessary, but along those lines it seems an accurate result could be obtained.

Q. In the course of your testimony regarding the charge of this bittern, you stated, at page 481, line 7, of the transcript, as follows:

“It would seem to me that the purpose of using bittern as you have described it would be to produce the main product and not the by-product and I would not be inclined to allocate any of the basic material costs to the by-product.”

Now, that assumption was not based upon any actual or factual knowledge of the processes of this plant, is that true?

A. That is true. It was based upon the assumption that gypsum here is a by-product.

Q. Let us assume this, Mr. Webster: Let us assume that this plant at Newark is producing bromine, gypsum, and magnesia products, and let us assume that there was a contract covering the sale of the magnesia products, in which contract the price to be paid is dependent upon the cost of producing the [526] magnesia products, and let us assume that you were employed by the buyer under that contract of the magnesia products to determine

(Testimony of Paul K. Webster.)

the cost of production of magnesia and, consequently, the price that your client is going to pay for it, and assume that you went over the books and records of the seller and you found that all general expense, all supervisory expense, all overhead expense, all indirect charges were charged to magnesia and no portion of it charged to gypsum or to bromine. Do you think that as an expert accountant, and having in mind the service to your client, that you would approve of that method of accounting and would you approve the magnesia being burdened with all overhead and all indirect charges, or would you be inclined to take the position that inasmuch as the gypsum is being produced in the plant, it should bear some portion of those charges and that your client should not be obliged, through the purchase of the magnesia, to pay them all?

A. Your first question would be the provisions of the contract under those circumstances, and presumably the contract would indicate what assumptions were to be made in the determination of costs. However, in the absence of that, if magnesium oxide were the main product of this process and the other products were by-products, I should expect the cost of the main product to be reduced by the amount recovered from the sale of the by-products.

Q. Let us assume that you found out that the same seller had a [527] contract for the sale of the gypsum where the price of the gypsum is depend-

(Testimony of Paul K. Webster.)

ent upon the cost of producing the gypsum, so that it becomes necessary for the purpose of that contract to determine the cost of producing the gypsum. Now, under those circumstances and having in mind that the cost of production of gypsum must be determined, would you, in service to your client, approve an accounting setup whereby your client, as the buyer of magnesia, would be saddled with all the overhead expense and indirect charges of this chemical plant?

A. If the gypsum were a by-product, and if the cost of production of the main product has been relieved of either the proceeds from the sale of the by-product or the cost directly attributable to the production of the by-product, I think there would be no ground for complaint.

Q. But you would insist on the aggregate recovery from the gypsum being treated as a reduction in the cost of the magnesia?

A. Either the aggregate recovery or the direct cost.

Q. But you would be perfectly willing for your client to pay a price for the magnesia based upon a cost of production which includes all overhead expense and all indirect charges in the plant, would you?

A. If that were the main product, and if the so-called overhead did not include items directly applicable to the by-product.

Q. May I just ask you this, Mr. Webster: Do you have readily available any treatises or texts or

(Testimony of Paul K. Webster.)

papers in which any [528] accounting authority has expressed the view that where you are going to determine the cost of producing a by-product it is improper to include overhead expense and indirect charges?

A. The difficulty with texts in general is that, in the first place, they are frequently written by college professors or others who are interested largely in the theoretical aspects rather than the practical aspects of the situation; and secondarily, they are trying to cover so many phases of the situation that they do not cover any one phase adequately. I have read numerous treatises on cost accounting and related matters. Many of them have no relation whatever to by-product accounting because it is a relatively minor phase of the science of cost accounting.

Furthermore, citation of those texts would not be very helpful because it is generally impossible to determine under what circumstances the texts were written. There is no way of determining what the author had in mind when he made a certain statement. The thing that is most apparent from reading texts on cost accounting and what you can find about by-product accounting is that the usual attempt is to cover the field very generally, presumably for the purpose of touching upon various phases of the problem and perhaps stimulating the thinking of students in relation to those problems. And I am not prepared to cite any particular text or article which would be particularly helpful

(Testimony of Paul K. Webster.)

in the determination of the problem we have in hand.

Q. So that you do not have anything of that sort? A. No.

Mr. Rosenberg: I think that is all.

Redirect Examination

Q. (Mr. Bennett): If, Mr. Webster, your client was the purchaser of a by-product where the contract or arrangement between the parties provided that the cost of that product to the purchaser, your client, should be based in connection with the actual cost of production or the cost of manufacture of the by-product, state what items you would consider proper in an accounting point of view to be included in the cost of production or cost of manufacture.

Mr. Rosenberg: I object on the ground it has been asked and answered and it is not proper cross examination and on the further ground when I asked the witness a question about the contract he said he would have to see the contract.

Mr. Bennett: Your Honor, that is hardly correct. Counsel asked, and Your Honor noted the last questions all had to do with a hypothetical situation where this witness——

The Court: I will allow him to answer the question.

A. In determining the cost of a by-product under the contract——

Mr. Bennett: The cost of production.

A. The cost of production of a by-product.

(Testimony of Paul K. Webster.)

Q. Or cost of manufacture. [530]

A. I should consider as applicable to that problem those costs which were directly and solely attributable to the production of the by-product and were identifiable or ascertainable as such.

Q. You would exclude other items of cost?

A. I would exclude items which did not fall within that definition.

Mr. Bennett: I am doing this to be of some aid to the Court in summarizing the witness' testimony in line with the cross examination. Will you take Exhibit E of defendant's answers to interrogatories?

The Court: What page?

Mr. Bennett: This is Exhibit E—if you wish me to turn to it, I will.

Q. Keeping in mind the identification or classification of the items of charges for the two year comparative period, namely, the year 1943 with the year 1942 and also the explanation of the manner of determining or measuring the costs as appears on the left column, will you state what items of increase, if any, shown for the year 1943 would be included under your view and experience as proper to be included in the increase, the actual advance in the cost of production.

Mr. Rosenberg: Just a moment. Are you offering that in evidence? Are you going to have the same argument we had about F? [531]

Mr. Bennett: I am referring the witness now to Exhibit E of the defendant's answers to plaintiff's interrogatories, Your Honor.

(Testimony of Paul K. Webster.)

Mr. Rosenberg: This is not in evidence.

Mr. Bennett: Well, I will offer this Exhibit E in evidence as the plaintiff's exhibit next solely for the purpose of showing the claim and representation and statement of the defendant in answer to plaintiff's interrogatory as to the claimed or alleged items of cost of manufacture pertaining to the product in question and the contract in question for the year 1943 over the year 1942.

The Court: Let it be admitted and marked.

Mr. Bennett: And the explanation as given in the right-hand column by the defendant.

(Exhibit E to defendant's answer to plaintiff's interrogatories was received in evidence and marked Plaintiff's Exhibit 17.)

PLAINTIFF'S EXHIBIT No. 17

	Year	Year	
	1943	1942	
9.			
(a)	\$2.71	\$1.93	
(b) Labor—Operations	.39	.26	Actual time card dist.
Labor—Repairs	.16	.12	Actual time card dist.
Comp. Ins. & S.S. Taxes	.03	.02	Follows Labor
Materials—Operations	.02	....	S'room req. & Direct Purch.
Materials—Repairs	.07	.06	S'room req. & Direct Purch.
Bittern (1)	.20	.20	Arbitrary Allocation
Water	.01	....	At cost—measured
Power	.18	.15	At cost—measured
Fuel	.14	.10	At cost—measured
Overhead (2)	.82	.42	Allocated—Labor basis
Taxes, Ins. & Depr. (3)	.49	.41	Allocated—% roughly based on plant value
Inter-departmental charges	.01	....	At cost
Ship. Expense (4)	.19	.10	Actual cost plus pro-rate of Misc. Ship. Expense

(Testimony of Paul K. Webster.)

		Year	Year	
		1943	1942	
9.				
(c) (1)	Gypsum	.20	.20	per ton
	Bromine	16.60	15.80	per ton
	Magnesia	1.11	.96	per ton
(2)	Gypsum	5.3%	5.0%	
	Service Accounts	2.7%	2.9%	
	Lime	11.6%	7.9%	
	Ethylene Dibro-			
	mide	17.1%	16.3%	
	Magnesia	63.3%	67.9%	
(3)	Gypsum	8.1%	7.1%	
	Service Accounts	2.2%	2.1%	
	Lime	25.2%	23.3%	
	Ethylene Dibro-			
	mide	11.2%	18.7%	
	Magnesia	53.3%	48.8%	
(4)	Gypsum	3.7%	6.2%	
	Lime	11.1%	14.7%	
	Ethylene Dibro-			
	mide	4.6%	4.8%	
	Magnesia	80.6%	74.3%	

Mr. Rosenberg: Mr. Bennett, isn't this going to be a reiteration?

Mr. Bennett: No, it is not.

The Witness: The first item, labor-operations, shows a cost here of 26 cents and 39 cents based on the actual time card distribution.

Q. How much is the increase?

A. That seems to justify an increase of 13 cents. My testimony, [532] of course, is based upon the acceptance of these figures as being a correct statement of what they purport to indicate.

Labor-repairs here indicate an increase of 4 cents. Compensation insurance and social security taxes which is stated "Follows Labor," I presume that means it is a direct charge, increase 1 cent.

(Testimony of Paul K. Webster.)

Materials-operations based on company requisitions and direct purchases show an increase from zero to 2 cents. Assuming again that there were no materials of that nature in the earlier period and that there is not a change in method of accounting, the 2 cent increase would appear to be allowable. However, if the comparable items in the earlier period were charged to some other account and should have been charged here, then the item should be entered in the 1942 column for the purpose of determining how much increase would be allowable, so with that qualification the increase of 2 cents may be allowable.

Q. Next item.

A. Material repairs, an increase of 1 cent appears to be all right.

Bittern, there is no change. Water, there is an increase of 1 cent, which appears to be a direct item. However, there is no item in the 1942 column and it again raises the question as to whether there may have been a change in the method of accounting. [533]

Q. But on the assumption that there was not.

A. The 1 cent would certainly be allowable as a cost item if it actually represents an increase. Power, increase 3 cents. This appears to be all right. Fuel, increase 4 cents, which appears to be all right. Overhead——

Q. Just a minute. In relation to overhead——

The Court: It has to do with labor?

Mr. Bennett: What did you say, Your Honor?

(Testimony of Paul K. Webster.)

The Court: On the labor basis?

Q. (Mr. Bennett): Assuming in relation to the items listed there as overhead, that item of overhead, that charge would have been incurred if the by-product had not been produced but in lesser and unascertainable amounts, would or would not that be included as cost of manufacture or the amount of any increase for the year 1943?

A. I think any item of this nature to be includable should be included on the basis of identification and ascertainment of the amount and, accordingly, based on the information before me at present, I would be inclined to exclude it.

Q. I will ask this specific question and I am referring now to the statement of the defendant, Your Honor, on page 7 of the answer to interrogatory 10(g), the second sentence of 10(g) on page 7. Assuming that those overhead charges listed there would have been incurred if no gypsum had been produced but in a lesser and unascertainable amount, would any increase in that [534] item be included or should be included?

A. In my opinion, no.

Q. What is the next item?

A. Taxes, insurance and depreciation which increased 8 cents.

Q. Assuming that that insurance relates to insurance other than social security and compensation insurance you referred to and allowed increased 1 cent in that period. State whether that would be allowed and if dependent upon any condition, what condition.

(Testimony of Paul K. Webster.)

A. Well, it represents——

Mr. Rosenberg: Just a moment: If you are going to write down any figures on that assumption, Mr. Bennett, I will object to the question on the ground that there is no foundation for that assumption. It assumes something that is not in evidence. This witness is on redirect examination and he is an expert witness.

Mr. Bennett: Well, I will reframe the question. Perhaps I can avoid the objection. Assuming that there is an increase in insurance in the amount of 1 cent in that period, state whether or not that should be included.

Mr. Rosenberg: I object to that on the ground it assumes something not in evidence.

Mr. Bennett: Counsel, so we can get along here and save time, I will ask you to stipulate if it is not a fact which should, I think, be before the Court, that in this summary of [535] charges that you furnished to the plaintiff after the case was filed and concerning which you introduced a letter yesterday to Mr. Kaapcke, shows that you claim that for the year 1943 there was an insurance cost for the gypsum operation, an increase of 1 cent over the preceding calendar year.

Mr. Rosenberg: Mr. Bennett, I am not going to stipulate as to what the contents of a written document are, because the written document is the best evidence and you don't require any stipulation from me. If you want to offer that in evidence you are perfectly free to do so. You told me

(Testimony of Paul K. Webster.)

the other day I was resorting to a trick. You have got that in evidence. If you want to put it in, you are free to put it in but don't ask me to stipulate what is contained in a written communication that I furnished to you because the written document is the best evidence of the information that was furnished to you.

Mr. Bennett: Well, I thought we could ask counsel to stipulate——

The Court: Where is the written communication?

Mr. Bennett: Right here. The communication that they gave to us outlining these matters.

The Court: Very well. Read from that.

Mr. Rosenberg: He can offer it in evidence. I have no objection.

Mr. Bennett: I see his purpose.

The Court: What is the objection to offering it in [536] evidence?

Mr. Bennett: Your Honor, I don't want to be bound by——

The Court: It is limited to that, of course.

Mr. Bennett: All right. I will offer it, this document entitled "Westvaco Charges Per Books to Cost of Production of Gypsum," consisting of five pages which the testimony already has referred to as being information which the defendant furnished to the plaintiff after the suit was filed and I offer it merely for the purpose of showing the charges claimed by the defendant and the costs alleged and asserted by the defendant for

(Testimony of Paul K. Webster.)

the calendar years 1937 to and including the year July 1, 1945 and to June 30, 1946. I am not offering it as evidence of the truth of the facts or figures shown upon the document, Your Honor, but to overcome the objection that counsel has to my request for a stipulation so we may proceed with the testimony of this witness.

Mr. Rosenberg: Just so the record may be clear, should be clear, I want to state that we object to any evidence relating to costs in the calendar year 1937, the calendar year 1938, the period from July 1, 1939 to June 30, 1940 and the period from July 1, 1940 to June 30, 1941, on the ground it is incompetent, irrelevant and immaterial and has no relation to any of the issues in controversy.

Mr. Bennett: I think that objection should be overruled because the testimony of this witness is not referring to that [537] period of time and if and when those matters are to be concerned, and they may well be concerned, Your Honor, we can dispose of the question when it arises.

The Court: I will allow it in subject to a motion to strike and over your objection.

(“Westvaco Charges Per Books to Cost of Production of Gypsum” was received in evidence and marked Plaintiff’s Exhibit No. 18.)

	July 1, 1945 to June 30, 1946		July 1, 1946 to June 30, 1947		Calendar Year 1947		Calendar Year 1948		July 1, 1948 to June 30, 1949		July 1, 1949 to June 30, 1950		Calendar Year 1950		Calendar Year 1951	
	Amount	Per ton	Amount	Per ton	Amount	Per ton	Amount	Per ton	Amount	Per ton	Amount	Per ton	Amount	Per ton	Amount	Per ton
TONS PRODUCED																
Direct Charge	\$4,032.11	36.53	\$4,097.26	37.22	\$4,417.54	38.31	\$2,646.34	21.71	\$2,337.57	20.20	\$1,308.61	11.70	\$1,223.55	10.77	\$2,085.73	17.40
Overhead and General Plant Expense	3,336.57	58.	2,475.64	74	2,010.53	52	1,340.49	42	1,124.60	35	813.66	27	520.57	17	548.53	22
Water	5,774.56	46	5,554.23	18	4,704.53	20	6,365.23	20	4,465.45	14	2,520.73	10	2,710.25	10	0-	0-
Insurance	1,975.41	11	6,746.3	62	4,052.2	12	3,281.13	11	7,547.71	22	6,246.3	22	8,171.3	18	0-	0-
Taxes (on real and personal property)	7,140.5	42	6,606.7	11	4,654.47	2	4,677.75	12	7,175.57	12	7,477.71	12	3,560.2	12	0-	0-
Depreciation	13,146.37	36	12,583.22	35	11,477.35	15	12,221.65	35	10,723.31	34	7,014.93	33	7,745.48	71	0-	0-
Interdepartmental Water	3,444.2	11	2,574.26	11	7,500	11	4,435	10	4,530	10	1,530.6	11	1,578.1	12	0-	0-
Sulphuric Acid	5,273.42	22														
Superphosphate	1,588.37	14	1,169.52	14												
Total Cost of Production	103,755.10	254	77,237.78	231	61,470.52	252	55,495.70	174	53,314.07	166	4,797.70	147	2,781.05	154	2,787.73	730
Shipping Expense (Actual not available)	10,629.61	28	7,091.51	21	4,724.04	19	5,554.37	19	5,720.32	18	5,369.58	19	4,436.6	13	11,274	30
Total Cost f.o.b. Cars	\$114,384.71	312	\$84,329.29	252	\$66,194.56	271	\$61,050.07	193	\$59,034.39	184	\$4,197.48	166	\$2,725.55	247	\$3,005.52	\$1,220

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Hidal

(Testimony of Paul K. Webster.)

Q. (Mr. Bennett): Assuming that for the period of the calendar year 1943, the costs of insurance increased on the claimed, or attributed to gypsum operations or properties increased 1 cent, should that be included?

A. Assuming that the item was allocated as being attributable to the gypsum operations and the basis of determining it is fair, then it may be considered a direct charge to gypsum and should be allowable.

Q. Those conditions that you have just mentioned, however, would definitely affect that question, whether or not they should not be included?

A. Yes.

Mr. Bennett: I am going to put up here, Your Honor, or down here, that item of insurance in question. (Indicating on blackboard.)

The Court: It is now about 12:00 o'clock and we will take a recess until 2:00 o'clock. [538]

Mr. Bennett: Your Honor, before you leave, may I ask a question? This witness has to leave—he has a very important engagement across the Bay that I noted to Your Honor yesterday. May I ask whether he could be called back out of order?

The Court: You will get me all out of order. The Court excused a witness before he concluded his testimony. Now, we are excusing another witness. How am I to follow his testimony?

Mr. Bennett: I was wondering if we could not accommodate the witness.

The Court: I will remain here until you conclude with him. How much time do you want?

(Testimony of Paul K. Webster.)

Mr. Bennett: I should say 5 or 10 minutes at the most.

The Court: Proceed. We will finish with him.

Q. (Mr. Bennett): The next item is taxes. Assuming that the taxes on the real and personal property affecting the alleged claim for the gypsum operations is the same in the two periods——

A. There would be no adjustment.

Q. In the case of depreciation, that the claim caused by depreciation for the calendar year 1942 was 38 cents and the calendar year 1943 was 45 cents and assume the depreciation was on the straight line method of calculation, state whether or not that item of claimed increase could be included.

A. I think it should be proportionate to the production. In [539] other words, if there was a substantial change in tonnage between the two periods that should be taken into consideration.

Q. Assuming that the tonnage of gypsum in the second period, namely, the year 1943, was 23 per cent less and the basis of the figuring or claiming depreciation was on the straight line, so-called straight line basis, then state whether you think that would be proper to include.

A. Can you tell me whether the amount of the straight line depreciation went up as between those two years?

Q. Assuming for the calendar year 1942 there was a depreciation claim of \$12,211.68, and for the calendar year 1943 there was a claimed deprecia-

(Testimony of Paul K. Webster.)

tion of \$11,099.35, or more than a thousand dollars decrease in the amount claimed for the second period.

A. Then I should think there would be no increase and possibly a small decrease.

Q. Next item.

A. Next item is interdepartmental charges which are not explained and are stated to be at cost. If they are directly attributable to the manufacture of gypsum, the increase of 1 cent would probably be allowable but it would require explanation as to the nature of the charge.

Q. Assuming that that particular item if charged would have been incurred if no gypsum had been produced but in a lesser and unascertainable amount, what would you say as to whether it should be included?

A. Then I think——

Mr. Rosenberg: I object to that. No foundation for that. The witness just said it would prove to him this was a direct charge.

The Witness: It is stated to be at cost, which would imply it is a direct charge, which would be allowable. I don't know the nature of the charge.

Q. (Mr. Bennett): Whether or not you would allow that would depend on whether it was a direct——

A. Whether it related specifically to the production of gypsum; also, there is the same qualification as to whether it was accounted for in the same way in depreciation on the preceding period

(Testimony of Paul K. Webster.)

because no charge appears in the preceding period.

Q. Next item.

A. Next item, shipping expense in which there is no change.

Q. Now, with the addition of the items that you have thought should be includable, it would show an increase over those two years of 29 cents, would it? A. That is correct.

Q. The increase of the second year, 1943, over the previous year, 1942, would be 29 cents and then there is the item interdepartmental water, 1 cent, and insurance, 1 cent. A. Yes.

Q. And they should be included without discussion of it further [541] and the other things, the further facts which you mentioned. A. True.

Q. Will you quickly turn to Exhibit F of the plaintiff's interrogatories, which is already in evidence.

Mr. Rosenberg: I will submit this was gone into on direct examination and it is being re-asked only for the purpose of making a display on the black-board, I assume.

Mr. Bennett: Well, I thought it would be of aid to the Court.

The Court: If it was gone into, you have a record.

Mr. Bennett: It has not been gone into with specific reference to the figures. It is conceivable on the argument we could spell it out, but there may be a dispute about the facts. I thought we

(Testimony of Paul K. Webster.)

could have them definitely determined by the witness' testimony.

The Court: Well, I think we are going over this testimony unnecessarily. We have every figure here that has been developed so far.

Mr. Bennett: Well, all right, Your Honor, if you don't wish—the second period has to do with the third price increase. I thought the witness' testimony would be specific.

The Court: I am sure you gentlemen, neither of you, will overlook anything.

Q. (Mr. Bennett): Mr. Webster, in dealing with the accounting methods to be applied in any particular situation, wherein [542] the conditions might vary, state whether or not in the determination of the method of accounting whether there are certain underlying, well established accounting principles that should be applied.

A. Well, yes, it seems to me whether there are accounting principles or not, there are certain standards that should be applied. In this type of a problem accounting should be considered as a tool of management; one of the basic functions of accounting is to furnish management with information from which management can make important decisions. If a decision to be made by management is whether to save and sell a product which would otherwise be waste or to discard it at some stage in the process, then it seems to me that information should be developed from the accounting system to indicate the cost of saving and selling that

(Testimony of Paul K. Webster.)

material as against the cost of discarding it at some point.

Also, it seems to me where you have a contract between two parties relating to the furnishing of a product that where the cost of that product is an important element in the contract, that the selling party, the producing party is under a certain obligation to include in his cost only the costs that specifically relate to the production of that product and not unrelated costs, and that in the fourth place, where an increase or decrease in the cost of a product is an important factor, that it is highly important that the same method of accounting be followed in both periods which are under consideration in order that you may here show increase or decrease resulting from a change in the method of accounting rather than from a change in actual cost production.

Q. Directing your attention to the chart which is Plaintiff's Exhibit for identification 16, assuming that in the manufacture of the primary product from which product it is necessary to remove an impurity or a substance the removal of which is necessary to produce the primary product and that substance removed is the thing that is further processed for sale; state whether or not, in your opinion, that would constitute a by-product or a co-product.

Mr. Rosenberg: I object to that on the ground it is assuming something not in evidence and it is not proper cross examination and it assumes a

(Testimony of Paul K. Webster.)

fact—if you want him to assume that there is a primary product, tell him what it is. What is the primary product?

Mr. Bennett: I thought I could do that the other way.

Q. Assuming, Mr. Webster, that the primary product in the manufacture is magnesium oxide, that the initial base material which is to be used is bittern which has already been described to you here, and assuming that to the end that in the manufacture of this primary product, magnesium oxide, it is necessary to remove the sulphate from the magnesia or other chemical [544] compounds which otherwise would preclude the manufacture of the primary product if it were not removed from the base liquor and that that product which is removed is for purpose of sale further processed by drying and grinding and delivering to the cars, whether you would consider that product which is removed, and subsequently further processed, a main product or a by-product?

A. It would appear to me to meet the definition of a by-product.

The Court: That five minutes is now nearly twenty minutes.

Mr. Bennett: I think that I am about through. There are several other matters. Thank you, Your Honor.

The Court: Now, you wish to ask some questions.

Mr. Rosenberg: I have one or two questions.

(Testimony of Paul K. Webster.)

Recross Examination

Q. (Mr. Rosenberg): These conclusions you gave with reference to Exhibit E are based upon the assumptions and the opinions that were expressed in your direct examination?

A. That is correct.

Q. With reference to the depreciation, I believe you have testified that keeping books of account on a straight line basis for depreciation, you can not say is not good accounting practice, but you think that for the purpose of this contract it would be better to keep it on the basis you said?

A. That's right. That is correct.

Q. In arriving at your conclusion as to which is a byproduct you were asked to assume that what is taken out is an impurity. I presume that would affect your conclusion——

A. Not necessarily. Whether it was an impurity or something taken out as an incident to providing for another product wouldn't make any great difference.

Q. We are dealing with chemicals now. Assuming that to get the product which is gypsum you have to add something to join up with the sulphate in the bittern water to make the gypsum that is to be processed, would that affect your conclusion?

A. That would depend on whether that addition were for the purpose of removing a substance from the main product or for the purpose specifically of producing the byproduct.

Q. Maybe we can get it this way: I will ask you something that you answered on cross-examination;

(Testimony of Paul K. Webster.)

before you, as an expert public accountant, would undertake to determine for accounting purposes whether this product should be treated as a by-product or a main product, you would require a great deal more detailed information than you possess at this time, isn't that correct?

A. Oh, yes. My information is rather limited for the whole problem.

Q. You would have to have more information than that assumed in the question which Mr. Bennett put to you?

A. Yes, except the question that he put me rather definitely, [546] comes within the line of the byproduct.

Q. But there should be more in consideration that would alter your opinion?

A. It is possible.

Mr. Rosenberg: That is all.

Mr. Bennett: I want to thank Your Honor very much for your indulgence.

(Thereupon an adjournment was taken until 2:00 o'clock p.m.) [547]

Wednesday, December 17, 1947, 2:00 P.M.

The Court: You may proceed.

Mr. Bennett: Will you take the stand, Mr. Flick?

C. BRUCE FLICK

resumed the stand, previously sworn.

Mr. Bennett: I am proceeding now, Your Honor, with the redirect examination of Mr. Flick, which

(Testimony of C. Bruce Flick.)

was interrupted by Your Honor's indulgence to permit the calling of Mr. Webster out of order.

Redirect Examination

By Mr. Bennett:

Q. Mr. Flick, I show you herewith plaintiff's Exhibit No. 18 and direct your attention to the headings on the several sheets that appear on that exhibit and the segregation of particular items of cost or alleged costs and ask upon what basis, if any, those headings and the classifications were made by you.

A. I have previously testified that I wrote in these headings and account titles on the original schedules, of which this is a photostat and I took those headings and account titles from the headings and account titles furnished to me by Westvaco.

Q. Were these items or segregations of the items of cost or alleged costs grouped pursuant to your own interpretation or by reason of any grouping or classification made by the [548] defendant itself?

A. The grouping follows Westvaco's groupings and subtotals for groups I think you will find checks with the subtotals or group totals in the answers to the interrogatories.

Q. The actual figures written in, other than the calendar years at the top of the column, were figures that were written in, so far as you know, by the defendant or some agent of the defendant?

A. Yes.

(Testimony of C. Bruce Flick.)

Q. This explanatory note on page 3 entitled "Westvaco, Charges Per Books to Costs of Production of Gypsum, Overhead and General Plant Expense," that was affixed on there after you delivered the outline, the form to the defendant and prior to the receipt of the document filled in?

A. That is correct. I did not affix that explanatory note.

Q. And you assume that that was affixed by the defendant? A. Yes.

Q. I notice that in certain of these pages there is written in in pencil certain additional items under certain of the so-called title groupings. Was that written in or did it appear on the form that you submitted to the defendant at the time you submitted the form or did it appear afterwards and at the time you received it back from the defendant?

A. Well, those additional account titles or captions were filled in after I had filled in the original headings. The [549] handwriting is quite clearly distinguishable.

Q. Well, the dark handwriting, or that which appears to be in ink was written in by whom?

A. Written in by me. That is the majority of these account captions.

Q. The form that was submitted to the defendant contained these items that were written in in ink that you have described? A. Yes.

Q. The ones written in in pencil were not writ-

(Testimony of C. Bruce Flick.)

ten by you nor do they appear on the form as you submitted it to the defendant?

A. That is correct.

Mr. Bennett: I take it, counsel, that we can stipulate that those items were added to the form under the titles by the defendant, can we not?

Mr. Rosenberg: I am sure that is true, but I will say again for the purpose of the record I am not stipulating as to anything regarding a document that is not in evidence.

Mr. Bennett: Well, this is in evidence, counsel.

Mr. Rosenberg: I thought you put it in for the purpose of showing one item in there.

Mr. Bennett: No, I put it in for the purpose of showing, as I explained, the claim of the defendant for the amounts alleged or claimed by the defendant of the costs for these periods shown in the summary, these annual periods, and only for that purpose. [550]

The Court: Very well.

Q. (By Mr. Bennett): State whether or not from the classifications given to you by the defendant and upon which you filled out this form the items of taxes, insurance and depreciation were classed or listed by the defendant under the title or classification as overhead.

Mr. Rosenberg: What forms are you talking about now?

Mr. Bennett: The witness has testified all these groupings, the form he made out for you to fill in, was made out with certain classifications which he

(Testimony of C. Bruce Flick.)

followed from classifications which you had previously given.

Mr. Rosenberg: When and by whom? I would like to know that, Mr. Bennett.

Mr. Bennett: We can develop that.

Mr. Rosenberg: I think the record shows, if the Court please, we have in evidence at this time a statement of the production costs for the period from July 1, 1939, to June 30, 1940, and July 1, 1940, to June 30, 1941, furnished by the defendant to the plaintiff, and the same thing for the calendar years 1942 and 1943, and the same thing from the period July 1, 1944, to June 30, 1945, and from July 1, 1945, to June 30, 1946, and all of those sheets are in evidence, and I submit that they will show the form in which we submitted our figures to the plaintiff. I do not think it requires any oral testimony at all. [551]

Mr. Bennett: If that is so, what harm could there be in this witness getting the matter clear and succinct before the Court now?

The Court: That is the second time counsel has indicated that that is in the record. Yesterday he repeated the same language.

Mr. Bennett: It is true we can take the record and spell out to Your Honor an answer to this question, but it would seem to me it would facilitate an orderly understanding of the point later to be made here to have this witness, now dealing with a new document which has not been discussed yet except as a preliminary basis for a question

(Testimony of C. Bruce Flick.)

to the preceding witness, to show (a fact that I intended to show) that this document, Plaintiff's Exhibit 18, was made out, so far as the classifications of items appearing on the form, pursuant to the classifications previously given by the defendant, and my purpose was to show that the defendant at all times has treated taxes, insurance and depreciation, not under the title of overhead, but as a separate item.

Mr. Rosenberg: I will stipulate to that.

Mr. Bennett: Thank you, counsel.

Q. Reference was made, Mr. Flick, during your cross-examination to a transaction that you had with Permanente Cement Company wherein certain of this gypsum purchased from the defendant was sold by you to Permanente. When was that arrangement [552] first made?

A. The arrangement to sell the gypsum to Permanente was first made by Pacific with Permanente after the construction of the Permanente Cement plant, which was in 1940, and this contract with Westvaco was made, first, January 29, 1937, so that in the first few years of this contract we had no arrangement with Permanente.

Q. Is the contract with Permanente still in force and effect or has that ended?

A. It expired and it is not in force and effect any longer.

Q. Are you selling gypsum to Permanente?

A. No, we are not selling gypsum to Permanente.

(Testimony of C. Bruce Flick.)

Q. In that connection, to clear up one matter, you stated, as I understood, the price you charged for gypsum at the Gerlach plant was what?

A. I think I mentioned a price for gypsum for cement retarder at our Gerlach plant at the present time as \$3.50 per ton loaded bulk on board cars at our Gerlach plant.

Q. If that product was sold from the Gerlach plant for delivery into the San Francisco Bay Area, there would be added to the base price the freight?

A. The buyer, wherever he may be located, would pay the freight from Gerlach to his destination.

Q. Do you know what the freight rate is from Gerlach to San Francisco Bay Area for Gypsum per ton? [553]

A. I do not know precisely. I think it is in the neighborhood of perhaps \$3.80 a ton.

Q. During your cross-examination the question was asked whether or not the building of facilities in the manufacture of the byproduct would have any effect in your mind in answers given. I will ask whether in your opinion as a expert public accountant, the building of facilities in the manufacture of the byproduct, would have any effect in your mind in answers given. I will ask whether in your opinion as an expert public accountant the building of facilities in the nature of additional buildings, if necessary, and additional machinery for the processing of the byproduct itself, and not related to the production of the main prod-

(Testimony of C. Bruce Flick.)

uct, would, in your opinion, alter or, for that matter, influence the question or determination of whether that product produced in that additional plant of facilities was or was not a byproduct.

Mr. Rosenberg: Mr. Bennett, your question carries with it the assumption that it is a plant to process a byproduct. You are asking him whether or not the fact that you have a plant to process what you have already classed a byproduct changes the character of the product?

Mr. Bennett: Maybe that objection is good, counsel. It is an awkward question, in any event. I will try to state it another way and quickly:

Q. Would the building of additional facilities, such as a shed [554] or plant, and the additional machinery for the processing of a product in and of itself, affect, in your opinion, whether or not that product was a co-product or a main product or a byproduct?

Mr. Rosenberg: To which I will object on the ground it has been asked and answered. It is not proper redirect and it is an attempt to impeach the witness. The witness stated on direct examination and on cross-examination that one of the considerations that would influence his determination as to whether a product is a byproduct or a joint product is the purpose for which the plant was constructed. Now, the purpose of this question, I guess, is to change that testimony. If it is, I submit it is improper as an attempt to impeach plaintiff's own witness.

(Testimony of C. Bruce Flick.)

Mr. Bennett: No.

The Court: I will allow the question subject to your motion to strike and over your objection. You may answer.

The Witness: Well, the consideration whether a plant was built to take care of the contemplated processing of a byproduct or whether a plant might subsequently add equipment for the purpose of processing a byproduct does not in itself alter the character of the byproduct as a byproduct. The essential nature of a byproduct, as I have tried to testify, is in my thinking the processing of a material which might otherwise be a waste material or something which is produced incidental to [555] a primary product, and that holds no matter whether the plant might be originally laid out to take care of that processing or whether at some later time it might be decided to add some equipment to process the byproduct.

Q. (By Mr. Bennett): If the plant was built for the purpose of producing a primary product or a main product, was the fact that facilities were also added for the manufacture of a byproduct influence or have any effect on your determination that such byproduct was in fact a byproduct?

A. I do not think so. I think that whether a product is a byproduct, according to the definition of byproduct that I have expressed, depends on the nature of the product and its relationship to the primary product and not merely on whether the plant was built in contemplation of having the

(Testimony of C. Bruce Flick.)

byproduct processed or whether some equipment might be added at some later time.

Q. Now, in a situation, Mr. Flick, where in the process of the operation of your plant no costs for processing are charged against a certain product up to the point of separation of that product from the other products, according to your understanding of accounting principles, would that be, up to that point, an indication of whether the accounting was for a byproduct or a co- or a main product?

A. Well, I have testified that in byproduct accounting principles, No. 1 is that if it is a byproduct which requires [556] processing to give it market value, that the first principle is that you do not assign as part of the cost of manufacture of the byproduct anything prior to the point when the byproduct is separated out or split off from the main product, and that you then assign only those out-of-pocket costs to put that material into marketable condition after it has been split off or separated from the main product, so that therefore it follows as a corollary that if the accounting did not charge anything to this cost of manufacture of the byproduct prior to the point of separation, why, that would appear on the face of it to me to reflect the position that the product were a byproduct.

Q. (By the Court): Where would you say the point of separation was here?

A. As I view the case of this byproduct, gypsum, the gypsum is not separated until it is filtered

(Testimony of C. Bruce Flick.)

out and the filtered cakes, the solids which are filtered out, are dried and ground and become this commercial gypsum.

Q. What has gone on before is divorced entirely away?

A. That is divorced entirely away. The liquid from the filter contains the magnesium chloride and goes on to the major product, the primary product of production.

Mr. Bennett: In this case, counsel for the defendant has stated that up to this point of separation of this filter cake, no processing charges are made by the defendant against the product gypsum, no direct charges. [557]

Q That would be consistent, at least so far as it goes, with your theory of cost accounting for a byproduct, would it not?

A. Yes. If no charges are made prior to the point of separation, that is consistent with what I have stated to be good accounting for a byproduct.

Q. Assuming that this calcium sulphate, which is precipitated out of the fluid at a point in the process, and which is later dried, ground and delivered, was a co-product, what would be the accounting procedure for direct charges up to the point of separation?

A. Well, in accounting for co-products or joint products, it is customary to charge all of the costs to the different joint products. For example, we have used as an example our Gerlach, Nevada,

(Testimony of C. Bruce Flick.)

plant, where we make, let us say, four products from the gypsum rock that comes down from the quarry. Now, the rock and all of the costs are charged to those four joint products.

(At this point the grand jury reported to the Court.)

Q. (By Mr. Bennett): Going back for a moment to the chart, Plaintiff's Exhibit for identification No. 16, as I understood, Mr. Flick, to the bittern water is added the calcium chloride; is that your understanding of this process?

A. Yes.

Q. One of the first steps before the filter cake or the gypsum is taken off? A. Yes. [558]

Q. We might say that we start here with not only the bittern as a base material, but the calcium chloride, which is added, is that correct?

A. That is correct.

Q. In your discussions with Mr. Williams or Wallace of the defendant, were you given to understand, was the matter explained to you as to why this calcium chloride was added to the bittern water? A. As to why?

Q. Yes.

A. I do not remember a specific discussion with Mr. Williams and Mr. Wallace. I believe that Mr. Wallace, in a general way, explained the processes at the time I was at the plant, and these chemical reactions have been quite widely publicized. It is common knowledge. They start with the bittern water because it has got the magne-

(Testimony of C. Bruce Flick.)

sium sulphate in it and they have got to convert that into a form which is usable to get magnesium oxide eventually, and in order to do that the calcium chloride is added. Now, that is for two purposes, really, as I understand those chemical reactions. The first purpose is to break up that magnesium sulphate combination. That is what happens when you add calcium chloride. They both break up, and then they recombine chemically so that you get magnesium chloride, which can then be carried along for the further processing to eventually get magnesium oxide, and you also [559] accomplish the removal because the calcium combines with the sulphates in the bittern—you accomplish the removal of the sulphate, which would be, as I understand, an impurity if it were allowed to remain in. You have got to get rid of the sulphates before you can proceed to get your primary product.

Q. Magnesium oxide?

A. Magnesium oxide. [559-A]

If I might add a little bit to that with specific reference to the two weeks in September, 1946, when Westvaco did not dry and grind the gypsum but dumped the material into the Bay, my understanding is that they proceeded with the same filtering and process and they did not change the process at that time other than that they simply dumped the filter cake.

Q. Now, in the operation of your Gerlach plant, when you say you manufacture only main or co-

(Testimony of C. Bruce Flick.)

products, if you stop the production of one of your main products, such as gypsum board, would there be any waste or dumping of any of the material that you had previously manufactured?

A. No. You have at Gerlach no problem at all of a waste or of a material which you have to remove for a byproduct or anything of that character. You bring down from the quarry your pure gypsum rock. Then you can make any of these four products from it.

Q. If you stopped one, then that raw product goes into the other; is that correct?

A. Yes.

Q. As I understand it, Mr. Flick, up until January 29, 1944,—this is preliminary, Your Honor,—you did not know or understand that the defendant had claimed in so far as the first increase of 18 cents that any part of that 18 cents involved anything other than direct charges; is that correct?

A. That is correct. Until January, 1944, I had no knowledge [560] that the original 18 cent increase was based on anything other than direct charges.

Q. And that the only information you had in your file was this letter of October 2, 1941, which is Plaintiff's Exhibit 1, which has already been in evidence and which listed—the letter from Mr. Hurlburt, the chief accountant, Westvaco Chlorine Products Corporation, that listed or stated, "We are attaching hereto an increase of labor, material and power cost which amounts to 15 cents per ton

(Testimony of C. Bruce Flick.)

of the 18 cent per ton increase of which you have been previously notified''; up to that time was there anything else in the file or had you been told by anyone either from Westvaco or your own company that any part of that 18 cents was for the direct charges as distinguished from indirect charges? A. No.

Q. What was your understanding up until the time you received this letter of January 29, 1944, Defendant's Exhibit A for identification, as to what the charges involved in that 18 cent increase were?

A. I understood they were direct charges. Mr. Hurlburt's letter set out three items that were, that made up 15 cents of the 18 cents and I understood the other three cents was direct charges but too minor to set up in detail.

Q. (By the Court): You discussed these matters orally before or after this letter? [561]

A. Orally with whom, Your Honor?

The Court: Who?

A. Mr. Canvin.

The Court: Yes.

A. Yes, with Mr. Canvin. Mr. Canvin died on June 3, 1944, so I did discuss with him and he accompanied me on my first visit to Westvaco in January, 1944.

Q. (By Mr. Bennett): Was anything said?

Mr. Rosenberg: Just a moment. Your Honor understands Mr. Canvin was in the employ of Pacific Portland Cement Company, not Westvaco.

The Court: I understand.

(Testimony of C. Bruce Flick.)

Mr. Rosenberg: I object to any——

The Court: Self-serving declarations?

Mr. Bennett: I don't think it would be in this case, because it was at——

The Court: How could they be bound by any oral discussions between themselves?

Mr. Bennett: Well, they are contending that we had knowledge, I assume, prior to 1944, that this 18 cents, the first increase was based upon indirect as well as direct charges and that by our subsequently paying that increase that we are in some way estopped from questioning the matter.

The Court: I might have confused you in my question. Did you discuss the subject matter of this letter before or [562] after with any of the defendants? I want to get straightened out on the testimony.

The Witness: My discussions with the defendant Westvaco were only from January, 1944, and thereafter. This letter of 1941, that is the one from Mr. Hurlburt——

Mr. Bennett: Yes.

A. To Mr. Canvin—that was written——

The Court: That is what I wanted to follow, the testimony there.

Mr. Bennett: I wish Your Honor would interrupt whenever you wish. Is there any question in Your Honor's mind about this short letter of October 2, 1941?

The Court: I was confused. I thought it was 1944.

(Testimony of C. Bruce Flick.)

Mr. Bennett: No. I would like to read this again in view of the confusion.

The Court: That occurred in 1944, what we have been discussing.

The Witness: Before January, 1944. In January, 1944, I made my first trip to Westvaco to look at their operations.

The Court: Yes; I got confused on the date only.

Q. (By Mr. Bennett): Up to that time no one either in your employ or connected with the defendant had ever advised you that any part of this 18 cent involved direct charges or other than direct charges? A. No. [563]

Q. When was the first time that you had any knowledge or information that any part of that 18 cent increase, the first increase that was asked for by the defendant in 1941, contained any element of indirect charges?

A. Well, that was after my visit to Newark on January 14, 1944. I later wrote a letter to Mr. Wallace or Mr. Cuneo. Mr. Cuneo replied and I don't recall the date, but it was later, I believe, in January, and gave me the same breakdown or classification of figures the 1940 and 1941 periods that I had just obtained from them for 1942 and '43. I was concerned primarily then with 1942 and '43 because they were then claiming a price advance of 78 cents a ton, so I became interested to see what they had charged in the earlier period in order to see whether there had been significant

(Testimony of C. Bruce Flick.)

changes in accounting classifications or what they might call changes in accounting practices. So I asked for the figures for the earlier 1940-'41 period which Mr. Canvin did not have in his file. He had in his file only this 1941 letter from Mr. Hurlburt.

Q. You mean Plaintiff's Exhibit 1. The letter you refer to from Cuneo is Defendant's Exhibit A for identification, the letter dated January 29, 1944, is it not?

Mr. Rosenberg: That is not A for identification.

Mr. Bennett: Well, it has the words "for identification."

The Clerk: It is in evidence.

The Witness: A. Yes, this is the letter I referred to, [564] Cuneo's letter of January 29, 1944, in answer to mine of January 18th.

Q. (By Mr. Bennett): That letter advised you for the first time, as I understand it, that there were indirect charges involved in that first increase back in 1941 of 18 cents; is that correct?

A. I don't know that I understand—you said indirect charges involving 18 cents. The entire amount of increase was 18 cents.

Q. Yes.

A. And that included indirect charges as well as direct charges.

Q. That letter advised you for the first time that it included indirect charges? A. Yes.

Q. Up to that time you did not know that fact?

(Testimony of C. Bruce Flick.)

A. That is correct.

Q. Why was it, if there was any reason for your continuing to pay that price of \$2.98 after you received the letter of January 29, 1944, from Mr. Cuneo?

A. Well, there were several reasons why we continued to pay the price of \$2.98. OPA price regulations had gone into effect by that time, and at that time the maximum price or ceiling price that could be charged was \$2.98.

Q. Had you been paying that \$2.98 up until that time from 1941? [565]

A. The contract began at \$2.80. The first increase was the 1941 increase of 18 cents which, as I recall it, was effective October 5, 1941, and since that time we have been paying \$2.98. The base month under OPA regulations was generally March, 1942, so the price was then frozen at \$2.98.

When we came to the first part of 1944 after I made by review of the figures,—you will recall that the original contract price was \$2.80, which was for the direct charges, the figures which Westvaco furnished me showed that on that first price increase of 18 cents 9 cents was for direct charges and that would have made the price \$2.89, if we just take the direct charge increase, and then the second claimed price increase for 1943 compared to 1942, the direct charges increased 29 cents, so that would have made the price \$2.89 plus 29, \$3.18, so that we were quite willing to pay based on direct charges that price which was then in excess of the

(Testimony of C. Bruce Flick.)

OPA ceiling price. That was one of the reasons why we did not feel that it would be fair or proper to try to go back under any circumstances to get a reduction in the \$2.98 price. Another reason why was that at the time the Westvaco people were claiming 78 cents increase, and wanted to file an application with the OPA for permission to charge \$3.76 and they were asking us to join with **them** in that application and threatening the discontinuance of the production of gypsum which we did not wish them to discontinue at that time due to our commitments and uses and, of course, [566] after I made my January review we almost immediately, I think, on February 4, perhaps, wrote a letter to Westvaco in which we stated our position on all of these accounting questions and under all the circumstances we acquiesced in the \$2.98 price. We did not agree with the accounting bases on which it had been computed but under these circumstances that I have mentioned we acquiesced in the price as a separate and distinct question from the other accounting bases. As I say, we made our position clear on the accounting problems, accounting questions involved. With that OPA ceiling price of \$2.98 we acquiesced in it, we paid the \$2.98 as I have testified, down until September 4, 1946.

Q. Now, from that time on up until the filing of this suit, this action we are trying now, did the defendant or any of its representatives or agents ever say or contend that you had ever by

(Testimony of C. Bruce Flick.)

paying the \$2.98 price, recognized the propriety of including in the cost of production or the cost of manufacture of gypsum indirect as well as direct charges?

A. No, they never said any such thing to me. All discussions and debates on which should be charged and should not be charged were always on the merits of the question and their insistence on their uniform national accounting system; they never made any such statement or point to me that we could not question the accounting costs by anything that had gone before.

Q. When is the first time that any such position was ever [567] called to your attention?

A. The first time it was ever called to my attention was in their answer after the suit was filed.

The Court: Have you concluded with this witness?

Mr. Bennett: Well, I am almost through, Your Honor; I am sorry.

Q. Mr. Flick, during your cross-examination counsel asked you with reference to certain figures that were on the board that I had placed there relating to the amount of deductions that were made from time to time by Pacific from the price paid because of the failure of gypsum content to measure up to the specifications provided for in the contract. Are you prepared at this time to state for the year 1942 the average per ton deduc-

(Testimony of C. Bruce Flick.)

tions that were made by your company for gypsum because of the substandard quality?

A. Yes, I have the figures.

Q. What was it in 1942?

Mr. Rosenberg: Just a moment. I object to that on the ground it is incompetent, irrelevant and immaterial. Let me explain this to the Court. This witness testified that in the early part of 1944 when he offered to pay \$3.29 a ton when according to our books, we were entitled to \$3.76 that Mr. Wallace said we could not sell it at price at a profit and then Mr. Bennett purported to put on the board what we would have made, the profit of 56 cents a ton we would have made had [568] we sold them the gypsum at \$3.29 at that time, in 1944. Let's see what they tell us of their credit deductions made during 1944, during 1945 and during 1946. These people were talking prospectively or backwards. If you want to develop 1944, 1945 and 1946, I have no objection.

Mr. Bennett: All right. We will do that, then. 1944, when did they tell you, when did Mr. Wallace or Mr. Williams say they had shut down their plant because they could not make any profit?

Mr. Rosenberg: Just a minute. The witness never said anything of the sort.

Mr. Bennett: Well, I will withdraw that question. There is testimony by the witness and you cross-examined him to some considerable extent with reference to a statement by Mr. Williams with reference to shutting down the gypsum production

(Testimony of C. Bruce Flick.)

because of the inability to make a profit. Do you dispute there is evidence about that fact?

Mr. Rosenberg: No. You said that they shut down the plant.

Mr. Bennett: I was mistaken in that connection, Mr. Rosenberg.

The Witness: As I recall it, it was in March, possibly in April, 1944, when Dr. Seaton, I believe, wrote a letter stating that they definitely would discontinue gypsum production on March 15 if we did not go along with them in the [569] application to OPA and if we did not give them a raise and would not pass on that price increase to our own customers in reselling the gypsum, and it was about that time when Mr. Wallace and Mr. Williams said that they would discontinue the production of gypsum because they said, "We can't operate this gypsum production at a loss."

Q. Now, for the year 1944, what was the average per ton deduction because of substandard gypsum or for any other cause?

A. For the period 1944 the deductions which we made—do you wish me to give the tons and the total——

Q. Per ton. A. Just per ton?

Q. Yes.

A. The deduction per ton, and this is after \$263.69 corrections which were included in this recent statement we have discussed before, the deductions amounted to four and a half cents a ton.

Q. Four and a half cents a ton.

(Testimony of C. Bruce Flick.)

Getting back, the cost given in the last period was \$1.00 plus shipping cost of how much?

A. Including the allocated shipping cost for the year 1943, their figure shows \$1.00 for direct charges and 19 cents for shipping expense.

Q. At the time of this discussion with Mr. Wallace and Mr. Williams and the letter from Dr. Sea-ton, you did not have the 1944 cost, did you? [570]

A. Why, no, because the time was then in March, 1944.

Q. What are the direct costs given in the figure that you have now?

Mr. Rosenberg: If the Court please, I submit this has all been gone into. This is merely an attempt to hit and hit and hit the same thing over again.

Mr. Bennett: I think counsel went into this at considerable length on cross-examination to show these figures were wrong. On redirect examination I think I can show they are not wrong, that there is only a deduction of four and one-half cents from the total price plaintiff was willing to pay. Plaintiff was willing to pay \$3.27 a ton. As I said before, the cost of production of the gypsum amounted to \$1.19 including this item of shipping and both direct and indirect charges. Now, the deductions come from the price we were willing to pay them and I show it was \$2.08 profit that they had made and they wouldn't make it if they shut the gypsum plant down. Counsel went in on cross-examination to show this is not a cor-

(Testimony of C. Bruce Flick.)

rect figure or figures, because there were deductions on account of substandard gypsum. I have shown to the witness that there was four and one-half cents per ton deducted for 1944, that would leave \$2.03 and one-half cents per ton still realizable as profit.

Mr. Rosenberg: Are you trying to tell us, Mr. Bennett, and tell the Court this is what you had on the blackboard? [571] Didn't you have \$3.27 and you said assume the correctness of that cost figure which was \$2.71——

Mr. Bennett: Well, I am coming to that, counsel. That is the next step here.

Mr. Rosenberg: You are saying this is what you had on the board. You did not have anything of that kind on the board.

Mr. Bennett: I had them and I had something like——

The Court: Well, in order to get straightened out, gentlemen, we will take a recess. [572]

Q. (By Mr. Bennett): As I understand, Mr. Flick, the price you were willing to pay was \$3.27 after they had asked for this second price raise?

A. Yes.

Q. And the total claimed cost of production that the defendant asserted, including indirect as well as direct cost, amounted to \$2.71, didn't it?

A. Yes, that was their total cost for the year 1943 as shown on their books.

Q. Which arithmetic leaves us the sum of 56 cents; deducting from that the 4½ cents deduction

(Testimony of C. Bruce Flick.)

that you made per ton in 1944 for gypsum being substandard would leave $51\frac{1}{2}$ cents profit, would it not? A. Gross profit.

Q. I hand you herewith two letters, and attached statements, both dated October 31, 1946, addressed to Pacific Portland Cement Company, and purporting to be signed by Westvaco Chlorine Products Corporation, O. D. Watt, Office Manager, and ask you whether you received the originals of those documents on or shortly after the date written? A. Yes.

Mr. Bennett: These are matters which are not in evidence. I offer these two letters in evidence, to be marked separately the next two exhibits in order.

The Court: They may be admitted and marked.

(The documents in question were thereupon received in evidence and marked, respectively, Plaintiff's Exhibits 19 and 20.)

Mr. Bennett: Exhibit 19, your Honor, is a memorandum of October 31, 1946. The letter attached reads as follows:

“Pacific Portland Cement Company
417 Montgomery Street,
San Francisco 6, California,

Attention: Mr. C. B. Flick, Vice President

Gentlemen:

We are attaching our statement in the amount of \$514.91 covering gypsum specification charge-

(Testimony of C. Bruce Flick.)

back deductions, for period 12/31/40 to 9/8/44, that you have made from our invoices that are not authorized by the terms of the agreement dated January 29, 1937."

And the attached statement shows under date 10/31/46, "Gypsum specifications charge-backs from 12/31/40 to 9/8/44.

"Pacific Portland Interpretation. \$2,599.09

Westvaco Interpretation 2,084.18

\$514.91"

The second letter, Exhibit 20, states:

"We are attaching our statement in the amount of \$8,457.62 covering gypsum specification charge-back deductions for period 10/10/44 to August, 1946.

"We assert that these deductions which you have made [574] from our invoices are not authorized with respect to shipments of gypsum made after September 8, 1944, by the express terms of the agreements dated September 8, 1944, and July 25, 1945."

And the attached statement, omitting the address, and so forth, reads:

"10/21/46 Gypsum specifications charge - backs from 10/19/44 to August, 1946, \$8,457.62."

Q. I will ask you if at any time, Mr. Flick, the defendant or anyone connected with the defendant called to your attention any objection specifically to deductions which you had made with-

(Testimony of C. Bruce Flick.)

out allowing the 2 per cent tolerance which you have testified was later discovered by you when you had the matter investigated?

A. No, they did not call my attention to the fact of any failure to give that 2 per cent tolerance allowance. I think I testified before that at the time they asserted these claims in 1946, which were a surprise to me because they had not asserted them during 1944 or 1945, I asked Mr. Wallace to give me detail and show me what was wrong with our deductions and I would be quite willing to check it and if we were wrong in any respect to make it right.

Q. I next direct your attention to Defendant's Exhibit E, which is a letter of September 23, 1946, which was in reply to your letters dated September 13, 1946, which were plaintiff's exhibits 11 and 12, respectively. Contained on page [575] 2 of Defendant's Exhibit E is the following statement at the bottom of the page:

"In answer to the above-entitled paragraph in your letter, we agree with you that in any calendar year in which you do not exercise your right to refuse to purchase and accept in excess of 20,000 tons of our gypsum production for the succeeding calendar year, that you are bound to purchase our entire production of gypsum deliverable to you in such year when offered to you in approximately equal monthly installments."

Did you ever make any such agreement to that effect?

(Testimony of C. Bruce Flick.)

A. We did not. I might say this, that the first letter which I wrote, dated September 13, 1946, was the longer of the two letters.

Q. That was Exhibit No. 11.

A. And after I sent that to Mr. Wallace we discussed it by telephone and I then wrote the second of the two letters dated September 13, 1946, which is the shorter of the two letters. Both letters were dated September 13th, but the first or longer letter was actually delivered or mailed September 13th. The second or shorter letter was actually delivered or mailed I think it was September 16th, and I was very much surprised when I received this letter of September 23, 1946, in reply, which referred to both of those letters dated September 13th, whereas one was intended to supersede the other, and I was [576] quite sure Mr. Wallace had so understood it. We did not make any such agreement as expressed in what you have just read.

Mr. Rosenberg: Mr. Bennett, if it would save any time, I am willing to stipulate that Mr. Flick wrote a letter denying the interpretation which you read on that 20,000 tons.

Mr. Bennett: To the effect that any agreement had been made.

Mr. Rosenberg: Yes, and my recollection is Pacific wrote a letter reiterating its position and then Westvaco wrote a letter reiterating its position, and that went on for some considerable time until somebody had the good judgment of saying, "There

(Testimony of C. Bruce Flick.)

is no use in our continuing to write letters asserting our respective positions.”

Q. That is about right, isn't it?

A. In general, that is about what happened.

Mr. Bennett: Thank you, Counsel. That will save considerable time.

The Court: You have consumed 12 minutes of that one minute you requested.

Mr. Bennett: That one minute, your Honor, referred to my examination concerning the chalk talk.

The Court: I think you have covered the matter.

Mr. Bennett: You may recross-examine, if you have any recross-examination.

Recross-examination

By Mr. Rosenberg:

Q. Mr. Flick, as I understand your testimony [577] now, you state that in view of the fact that in keeping its cost records with reference to gypsum Westvaco does not charge any processing prior to the point of separation, that you take that to be an admission by Westvaco that gypsum is for accounting purposes a byproduct, is that right, an indication?

A. Well, I do not think that I said that it was an admission by Westvaco. I said that one of the characteristic features of by-product accounting is that you do not charge anything prior to the point of separation, and therefore if you have a situation where the company involved is not charging anything prior to the point of separation, why, on

(Testimony of C. Bruce Flick.)

the face of it it looks to me as if that is in accordance with by-product accounting rather than joint product accounting.

Q. And by the same token would you say that the fact that Westvaco charges bittern, part of the raw material, to gypsum, would lead by parity of reasoning to the conclusion that Westvaco was treating it as a co-product or a joint product, is that right?

A. Yes. Westvaco had told me repeatedly that in their uniform accounting system they treat everything as if it were a joint product or a co-product.

Q. And according to your views it is improper to include in cost of production of a by-product any overhead charge, isn't it?

A. You would not include in the cost of production of a by-product [578] any charge which you would have if you discontinued the production of the by-product or which you would have in a lesser but unascertainable amount.

Q. So, if any conclusion is warranted from the method employed by Westvaco in keeping its cost accounts related to gypsum, the fact that it does include in the cost of production of gypsum overhead expense which would continue notwithstanding the production of gypsum, if you are going to draw any deduction from that, it would indicate that Westvaco, for accounting purposes, has been treating gypsum as a co-product, wouldn't it?

A. I think so. The Westvaco have repeatedly told me that they treat all products as joint prod-

(Testimony of C. Bruce Flick.)

ucts for accounting purposes, no matter whether they are by-products or not.

Q. When you visited the plant in 1944 Westvaco was making bromine, wasn't it?

A. I believe so.

Q. At that time were you informed that none of the processing in relation to the recovery of bromine is charged to magnesia? Were you informed of that fact?

A. I was not informed as to what was charged to bromine or what was charged to magnesia.

Q. I believe you repeated on redirect examination that one of the circumstances that influences your conclusion that gypsum is a by-product is that the sulphate is an impurity which must [579] be removed for the purpose of making magnesium oxide, is that right?

A. That is correct.

Q. Will you tell me this: If the magnesium were not removed from the calcium sulphate, then to the extent of the magnesium that you have in there, and conceiving that product as gypsum, the magnesium would be an impurity, wouldn't it?

A. Well, you can make all kinds of assumptions about what your primary product is, or about what your by-product is. We are dealing here with a particular situation. The plant was primarily designed to produce magnesium oxide.

Q. And that is one of the assumptions in which you have indulged?

A. It says so in the contract. I am not assuming anything there.

(Testimony of C. Bruce Flick.)

Q. I am not arguing with you, Mr. Flick. That is one of the assumptions in which you have indulged in coming to the conclusion that gypsum is a by-product, is it?

A. Well, I do not call it indulging in an assumption, because it is stated in the contract as a fact.

Q. Let us say it is a circumstance.

A. And in Dr. Seaton's magazine article he uses the term, himself: "This by-product gypsum would be a valueless waste if it were not for ability to sell it at a profit."

Q. What he said in fact is that the by-product gypsum would be a valueless waste unless it were for the favorable location of the plant in California, didn't he? [580]

A. Yes, but he describes it as by-product gypsum.

Q. In determining that gypsum is a by-product, you have considered and been influenced by the circumstance that the plant was built primarily to produce magnesium oxide, is that true?

A. Why, yes. The magnesium oxide is the primary product, worth \$46 a ton.

Q. How does the quantity of gypsum produced compare with the quantity of magnesium, do you know?

A. I have had no figures furnished on the relative tonnages. I might say in passing, as far as quantity is concerned, that that in itself does not necessarily govern as to by-products. I think in

(Testimony of C. Bruce Flick.)

my earlier testimony I used the example of the oyster company, which might have by-product shells that had a great deal more weight, perhaps, than the oysters, themselves.

Q. Let me ask you again, Mr. Flick, whether or not, if this calcium sulphate, which is gypsum, contained any substantial quantity of magnesia would it meet the specifications of this contract?

Mr. Bennett: That is getting into a realm here that I think you had already exhausted.

Mr. Rosenberg: He has read the contract.

Mr. Bennett: He can answer it. Go ahead.

The Witness: The contract speaks for itself. It says the gypsum shall be 97.51 per cent gypsum value, and if it drops below 95.51 per cent, then there is a penalty charge-back. [581]

Q. (By Mr. Rosenberg): And the specification states there shall not be more than 2.7 per cent magnesium, is that right?

A. I do not recall that detail, but the controlling thing we have been interested in is the percentage of gypsum value.

Q. With reference to this OPA ceiling, you did not mean to imply, did you, Mr. Flick, that because the maximum ceiling price was \$2.98, that Pacific could not pay Westvaco less than that price if it was entitled to a lower price under the contract?

A. I think I—let me say it again: The initial price was \$2.80. Westvaco's figures showed that the direct charges, which we were quite willing to recognize, had gone up 9 cents in 1941 and had gone

(Testimony of C. Bruce Flick.)

up 29 cents in 1943—that is 38 cents—and if you add 38 cents to \$2.98 you still come out with \$3.26. At any rate, even on the charges which we were quite willing to recognize, we would have paid more than the \$2.98, but the OPA would not let us. It froze the price at \$2.98. We were not interested in going back and trying to reopen something on that basis. And besides, at that time, as in fact ever since, our whole endeavor has been to find a practical way to get along under this contract and perform the contract, and we were offering at that time to arbitrate our differences. There just wasn't any point in trying to go back and reopen the price at \$2.98, with which we acquiesced, without any reference to the accounting questions, which we stated then and have ever since. [582]

Q. Referring your attention to Exhibit 19, which is a statement from Westvaco to Pacific for chargebacks from 12/31/40 to 9/8/44, it says, "Pacific Portland interpretation \$2,599.09; Westvaco interpretation \$2,084.18, difference \$514.91." Now, don't you understand from that statement, and weren't you told what was meant by Westvaco's interpretation, and Pacific's interpretation included the fact that we contended that you were not entitled to any moisture credit deductions if the gypsum content was 95.51 per cent or more, and that you in fact had taken credit deductions where the gypsum content equaled that amount but was less than 95.51 per cent, didn't you understand that?

A. No, I did not, specifically. I asked Mr. Wallace, since this statement said Westvaco interpre-

(Testimony of C. Bruce Flick.)

tation was different from Pacific—I said, “Send me the detail and show me where the difference in interpretation lies, and if we are wrong we will be only too happy to correct it.”

Q. And didn't Mr. Wallace have a meeting with you where he showed you that you had taken deductions that you now admit you were not entitled to take?

A. He never furnished me that detail and showed me where the interpretations differed.

Q. Did he ever make this general statement to you, Mr. Flick: “You people have been taking credit deductions where the gypsum content is 95.51 or more and under the contract you are [583] not entitled to such deductions unless it falls below that percentage.” Did he ever tell you that?

A. I do not recall his specifying that. As I say, I asked him to give me detail and show me where we were wrong in any case, and we would be glad to check it, and if we found he was right to send him a correction.

Q. Referring to Exhibit 20, which is the statement for \$8457.62, that covered all of the credit deductions that Pacific had taken from October 19, 1944, to August, 1946, didn't it? That was the total amount of credit deductions taken during that period, wasn't it?

A. Well, I could not be sure of that, Mr. Rosenberg, without rechecking it.

Q. You notice that the letter with which that statement was transmitted stated that, “We assert

(Testimony of C. Bruce Flick.)

that these deductions which you have made from our invoices are not authorized with respect to shipments of gypsum made after September 8, 1944, by the express terms of the agreements dated September 8, 1944, and July 25, 1945.' Now, those agreements that are referred to there were letters that transpired between Pacific and Westvaco, were they?

A. Well, one of them I think is one that you have already referred to, and that was an agreement that the price should remain at \$2.98, and I did not accept or agree with those assertions. [584]

Q. And at that time Mr. Wallace told you, didn't he, that he felt that the spirit of that agreement was that during the time that the price control continued you would not take any moisture credit deductions, and you insisted that there was no misunderstanding or agreement?

A. I told him that I thought to waive deductions of that kind under the contract would be contrary to my understanding of the OPA regulations, which prohibited raising of price, and that if you did not make deductions you would be doing the same thing as raising your price.

Q. I merely wanted that explained.

A. Whatever he said, as you have quoted him, was not in accordance with my view of the matter, and I believe that \$8000 claim has subsequently been dropped out of the picture.

Q. That is exactly what I wanted the court to understand.

A. Yes.

(Testimony of C. Bruce Flick.)

Q. You mean by dropped out of the picture, what? You have withdrawn that claim?

A. That is right.

Q. In other words, at that time Mr. Wallace contended that the spirit of the letter agreement was you would pay the \$2.98 price without any credit deductions and you denied in good faith—I am not questioning your good faith, but that was your understanding or intention, and so that is the way the matter was left? [585]

A. That is correct. It was not my understanding or intention, so far as the spirit of it was concerned, and I also told him that in my understanding of the OPA price regulations it would have been actually contrary to OPA regulations for us to discontinue making those deductions.

Q. And then subsequently, and I think it was after this suit was filed, Westvaco wrote a letter to you in which they sent a statement for the sum of approximately \$1600, which they claimed for deductions erroneously taken according to their analyses and their interpretation of the contract, and it was explained that that was in lieu of this larger sum that is evidenced by Exhibit 20, is that right?

A. I believe that is correct. That is my understanding.

Mr. Rosenberg: No further questions. [586]

Mr. Rosenberg: May I just look at my notes one second, please? I have no further questions.

Mr. Bennett: Step down, Mr. Flick.

WALTER G. DRAEWELL

called by the plaintiff, sworn.

The Clerk: Will you state your name?

A. Walter G. Draewell.

Direct Examination

By Mr. Bennett:

Q. Mr. Draewell, will you state your business and occupation?

A. I am a certified public accountant connected with Lybrand, Ross Bros. & Montgomery.

Q. That is a national firm of public accountants?

A. That is correct. I am in the San Francisco office of that firm, which is one of some 25 offices in the largest cities.

The Court: What is the name of the firm?

A. Lybrand, Ross Bros. & Montgomery.

Q. (By Mr. Bennett): You are a certified public accountant yourself?

A. I am a certified public accountant.

Q. How long have you been such?

A. I obtained my original certificate in the State of Michigan in 1926 and in California in 1930, I believe it was.

Q. How long have you been connected with Lybrand, Ross Bros. & Montgomery? [587]

A. Since I left the University of Michigan in about 1923.

Q. During that time and since that date you have been engaged in the practice of public accounting?

(Testimony of Walter G. Draewell.)

A. Continuously with the firm of Lybrand, Ross Bros. & Montgomery.

Q. To shorten this matter, Mr. Draewell, I will ask you whether in determining the cost of production or the cost of the manufacture of a byproduct what items of cost may be considered, according to good accounting practice?

A. Costs properly assignable to a byproduct are those which arise solely in connection with the byproduct operation and are ascertainable as such.

Q. Now, if the problem is the matter of comparing costs between given periods such as calendar years or any twelve month period for the purpose of determining, say, any increase or decrease in the cost of production or manufacture of a byproduct, state whether or not the same accounting methods should be employed in both periods.

A. The accounting methods when a comparison is being drawn between two periods should always be the same.

Mr. Bennett: Take the witness.

Cross-Examination

By Mr. Rosenberg:

Q. How do you define a byproduct as you used it in the testimony that you have given, Mr. Draewell? [588]

Mr. Bennett: So I may be consistent, I object to any questions as to what is or is not a byproduct because it is not proper cross-examination. The contract defines the term, the product in question as being a byproduct.

(Testimony of Walter G. Draewell.)

The Court: Overruled.

Mr. Bennett: And may that objection, to save time, run to like questions carried on?

The Court: Yes; that will be to the line of this testimony.

The Witness: A byproduct is a product recovered in the course of the production of a major or a primary product which might be in the form of a waste or impurity; it might be a material which to get the finished product will be withdrawn in the process or it might be something that is normally discharged in the course of operations in the processing of the material.

Q. Is it typical of byproduct as you can conceive it, that it is a valueless waste at the time that it comes off the production line, so to speak?

A. I think perhaps that is the most common concept of a byproduct, although I don't think it is necessarily so.

Q. Of course, you are familiar with the particular product that is involved in this litigation, are you?

A. Not directly.

Q. You have never been over to the plant? [589]

A. I have not.

Q. Over at Westvaco?

A. I have not.

Q. You are not attempting to express any opinion as to whether or not this particular product, gypsum, is a true byproduct or a joint product or co-product?

A. I am not.

Q. In other words, your testimony is completely objective and abstract, is it?

(Testimony of Walter G. Draewell.)

A. It is so intended to be.

Q. You state that in your expert opinion the only charges that should be included in determining cost of production of a byproduct are those direct charges, and if I misquote you, correct me, which are ascertainable and can be directly attributed to the production of the byproduct; is that your statement?

A. Essentially so.

Q. Is that uniformly accepted among accountants or is that your personal opinion after considering the matter generally, Mr. Draewell?

A. It is my opinion and I believe it is a more common practice and the common thought as among accountants generally.

Q. Of course, it is a common practice in accounting not to determine cost of production of a byproduct at all, is it not?

A. That depends upon the degree of importance of the byproduct. [590] The minor, trifling types of byproducts and the revenues therefrom are normally credited directly to the cost of the main product.

Q. Then, according to the exigencies and the circumstances of a particular case, you may, for business reasons, decide that it is necessary to determine the cost and keep cost records on both the product and the byproduct; is that not right?

A. You may or may not, as you see fit.

Q. Now, under similar circumstances, don't you agree that it is proper and customary to employ the same accounting methods and principles in ac-

(Testimony of Walter G. Draewell.)

counting for production of a byproduct as you do in the case of a joint product?

A. I believe perhaps when you are speaking of a byproduct, in that sense, perhaps you are speaking of a joint product rather than a byproduct.

Q. Let me put it this way: Aren't there accounting authorities who do hold to the thought that for accounting purposes any so-called byproduct that requires processing and refining to make it a marketable product, the same accounting methods and principles may properly be applied as in the case of a joint product or co-product.

Mr. Bennett: Now, we are asking him as to whether there are some accounting authorities.

The Court: Yes.

Mr. Bennett: I cite to Your Honor the case of *Davis v. [591] United States* by the Supreme Court of the United States, 165 U. S. page 373, and the particular portion of the opinion that I direct your Honor to is on page 377, a short statement by the Court.

The Court: You may cite it.

Mr. Bennett (reading): "After a witness has once qualified himself as an expert and given his own professional opinion in reference to that which he has seen or heard, or upon hypothetical questions, then it is ordinarily opening the door to too wide an inquiry to interrogate him as to what other scientific men have said upon such matters, or in respect to the general teachings of science thereon, or to permit books of science to be offered in evidence."

(Testimony of Walter G. Draewell.)

The Court: What is the factual situation there? What were they dealing with there?

Mr. Bennett: In that case a doctor was the witness, reading the remarks of the Court——

The Court: I want the factual situation.

Mr. Bennett: Yes, the facts are stated here by the Court in the opinion:

“In the course of his testimony, Dr. Amis stated that defendant ‘would sit down on his spittoon and gaze down on the floor as if looking at some object when none was there, manifesting no interest in anything that was going on; that although violently ill, he was indifferent and unconcerned during his [592] illness, was never worried about his condition, never saw any change in his expression, but he would sit and gaze in a dreamy, melancholy way, with his mouth open and underjaw hanging down, having a vacant, meaningless stare, his face expressionless—just a blank.’ In reference to this matter, he was subsequently asked this question: ‘What does medical science say as to that meaningless, vacant stare and the lower jaw hanging down in a listless way? What does medical science teach as to that?’ Which was objected to and the objection sustained and exception taken.”

The Court: My comment is that we are concerned here with relation to the interpretation of a contract where we are to develop by evidence from experts such as we have here——

Mr. Bennett: I won't argue it further, Your Honor.

(Testimony of Walter G. Draewell.)

The Court: Proceed.

Mr. Bennett: If Your Honor has made up his mind——

The Court: It is not a matter of making up my mind. I am frankly stating what I think.

Mr. Bennett: As I said, Your Honor, before, it is improper to attempt to go before the Court, as counsel sought to do with the previous witness, bring some book or something somebody said, some unsworn testimony, to bring that before Your Honor and the Courts have held in such cases in state and federal decisions numerous, indeed, that is not a proper subject of cross-examination, that the witness cannot be cross-examined [593] as to what somebody else might think. I make the further objection that by using such books or texts or any such things would be getting before the Court unsworn testimony where the other side has no opportunity to cross-examine.

The Court: It goes to the very vitals of an expert witness, what his knowledge is, the limitation of his knowledge, what he bases his opinion on. That is my thought.

Mr. Bennett: Well, I don't want to argue it any longer unless Your Honor wants argument.

The Court: No. I am giving you my state of mind. If I am in error, you will have an opportunity to correct me; that's all, that is the only reason.

Mr. Bennett: I thought I had done that. The witness can be asked as to the basis, he can be

(Testimony of Walter G. Draewell.)

asked by counsel if he wishes, what books he has read, what authorities or upon what bases he bases his opinion, but after he is qualified, and I submit that this witness has been qualified by both training and his experience and his certificate of admission to practice with certified public accountants, it is improper to get before the Court what some other person has said under circumstances where we cannot cross-examine, cannot identify the person.

The Court: As far as what somebody else said has no place in this case; that is obvious.

Mr. Bennett: Yes, Your Honor.

The Court: Proceed, counsel. [594]

Mr. Rosenberg: I think it is 4:00 o'clock. Do you wish to go on?

The Court: I am anxious to finish this case as I have other cases following. Proceed.

Mr. Rosenberg: I will put the question to you again. Is it a fact that there is a school of thought among professional accountants that holds to the proposition that where it does become necessary for one reason or another to determine the cost of producing a byproduct that it is proper to apply the same accounting principles and methods as those used in the case of any joint product or co-product?

Mr. Bennett: Same objection.

Q. (By Mr. Rosenberg): Will you answer the question?

The Court: Answer.

The Witness: I believe that there is a confusion between what is a joint product and a byproduct.

(Testimony of Walter G. Draewell.)

As to pure byproducts, I do not call to mind any accounting authority that advocates joint product accounting or have I in my experience encountered it.

Q. (By Mr. Rosenberg): You have never encountered that? A. No.

Q. Can you refer me to any treatise or text writer or paper that you have read which says that as a matter of accounting practice it is improper in determining the cost of production by a byproduct to include any indirect charges or overhead [595] expenses?

A. I cannot refer you to any specific one, no.

Q. Let me ask you, Mr. Draewell. Have you ever read—you are familiar with the National Association of Cost Accounting publication?

A. I am.

Q. I believe your firm is one of the charter members of that association, is it?

A. One of our partners.

Q. Do you read the official publication of that Association?

A. Not consistently. I am a member and I receive them.

Q. Have you ever read—you state you don't recall ever reading any text or treatise or paper that deals exclusively with the subject of byproduct accounting?

A. No, that was not your question.

Q. Have you ever read the official publication, Volume 1, No. 7, dated August, 1920, of the Na-

(Testimony of Walter G. Draewell.)

tional Association of Cost Accountants which is entitled, "Accounting for Byproducts"?

A. I have not.

Q. You have not read that. Assume, Mr. Draewell, that you have a chemical plant where the basic raw material is sea water from which a salt company extracts salt and that in this chemical plant you have three departments; in the first department you recover the bromine from the sea water and then after the bromine has been recovered from the sea water, this sea [596] water or bittern passes to another plant where gypsum is precipitated from it and is thereafter processed and refined, and then the bittern passes on to a third department or plant in the magnesium products which are recovered from this mother element, so to speak.

Now, in your opinion, on the basis of that hypothesis, can you state whether or not for accounting purposes it would be proper to treat those products as co-products?

Mr. Bennett: Just a minute. I submit the question is improper. It does not state a hypothesis that is applicable to this case. It could apply perhaps to an entirely different situation.

Mr. Rosenberg: I cannot tell from your objection wherein you differ with the hypothesis.

Mr. Bennett: There is no hypothesis that is applicable to such a situation in this case.

Mr. Rosenberg: I am perfectly willing to rest the hypothesis that I have stated.

(Testimony of Walter G. Draewell.)

The Court: In the interest of time, I will allow it. Objection overruled. Note an exception. Proceed.

The Witness: I am not familiar with the process of the raw material. If the bittern, I believe you call it, is the primary product which passes through each of these processes and it is then—in other words, if there is a diversion of bittern into various products, they would be co-products. If, [597] on the other hand, the basic material proceeds on to a final product which may be the end or the primary product, anything that passes off, if there is a specific material abstracted or withdrawn at a point before the final operation, both of them would be byproducts until you would have your primary product, the magnesium.

Q. It is your theory, is it, that if you have a chemical plant and you have a common raw material from which you recover a number of chemical elements, every process, every element removed is a byproduct up to the point where the raw material reaches the last point of processing?

A. Not entirely. You have first a primary purpose or primary product for which the plant is operating. I don't recall if there is a diversion of the product from the raw material or is it a removal of the raw material from that? If the primary raw material passes on into separate branches, it is really in effect a co-product.

Q. Do I understand your answer you are influenced in your determination of whether or not

(Testimony of Walter G. Draewell.)

the main and primary purpose of the plant is to produce one product?

A. Whatever the primary purpose is. You may have a main product, you may have joint products, all of which perhaps share jointly in the purpose for which the plant is being operated.

Q. The fact in the chemical industry where you take a common [598] raw material and at different stages of the operation recover different commercial elements from it, wouldn't cause you necessarily to conclude that each element removed up to the last point is a byproduct, would it?

A. If it was a diversion of the original raw material or in its form at that particular stage of the process, I would say it probably becomes a co-product; if on the other hand, it is—when a removal of an impurity or something that is not an impurity, something that is not necessary on the end product that may very well become and in some plants it would be regarded as being a byproduct.

Q. And when we are talking about the co-products or byproducts, we are talking in the accounting vernacular; in other words, you are using the term as it is recognized by accountants for the purpose of determining the accounting method to be employed in connection with it?

A. I have no knowledge of the scientific meaning of the byproduct.

Q. Let me ask you, have you had any personal experience in cost accounting for a chemical plant?

A. Such as I have had is so long distant that

(Testimony of Walter G. Draewell.)

the experience of itself is not worth the mention at this stage.

Q. So you know nothing of actual experience in a chemical plant upon which you base these particular opinions?

A. No. I had this experience, as far as magnesium oxide is [599] concerned, of the end product in the case being metallic magnesium which was produced differently, from the raw dolomite and following it through to magnesium oxide produced by process and then into the chemical plant by which process magnesium, metallic magnesium, was produced.

Mr. Rosenberg: I think that is all.

Mr. Bennett: That is all, Mr. Draewell.

The Court: We will recess now until tomorrow morning.

(Whereupon the trial was continued until tomorrow morning, Thursday, December 18, 1947, at 10:00 o'clock a.m.) [600]

Thursday, December 18, 1947, 10:00 o'clock a.m.

O. KENNETH PRYOR

was called as a witness on behalf of the plaintiff and being first duly sworn, testified as follows:

Direct Examination

Q. (Mr. Bennett): Mr. Pryor, will you please state your business and occupation?

A. I am a certified public accountant in the practice of public accounting. I am a partner of the firm of Price, Waterhouse & Company.

(Testimony of O. Kenneth Pryor.)

Q. Price, Waterhouse & Company is a firm of certified public accountants with offices throughout the United States?

A. Yes, we have many offices in the United States, an office in San Francisco, and in addition we have a great many offices throughout the world.

Q. You are a resident partner of that firm?

A. I am.

Q. How long have you been a certified public accountant?

A. I took the examination in New York State in 1929 and was granted my certificate in June of 1930.

Q. Since that time you have been engaged continuously in the practice of accounting?

A. I have, sir.

Q. Mr. Pryor, as an accountant, if you are to determine the [601] actual cost of production or actual cost of manufacture of a by-product, what elements or items of cost are to be included in any such computation?

A. Let me say one thing to start with: To my mind, as an accountant there is no difference between cost of production and cost of manufacture. They are synonymous terms, I believe, in accounting.

Q. You tell us what items or elements of cost are to be included in determining the cost of production or the cost of manufacture of a by-product.

A. I think that you might say that the elements of cost which are to be included in the cost of pro-

(Testimony of O. Kenneth Pryor.)

duction of a by-product would be those necessary expenses which are directly and solely attributable to that by-product and which you can ascertain in amount.

Q. In the case of a situation where not only the manufacturer or producer of the by-product but the purchaser of that product is concerned with the determination of the cost of production or the cost of manufacture of the by-product, and where there is a problem of determining and actual advance in the cost of manufacture, if any should occur in a twelve month period as compared to a previous twelve month period, what would be the elements or items of cost to be determined or upon which any such actual advance in cost of manufacture or cost of production would be based? [602]

A. You have set up a situation where it is important, of course, to determine cost based upon two comparative periods. In that situation there are certain things which have become very important, namely, the consistency of the application of the proper principles as to what elements should be included; I think, as I stated as to a general proposition, only those elements which are solely attributable to that by-product and which you can ascertain with exactitude. In other words, you do not have the leeway perhaps that you might have if you had some other purpose in mind in determining those costs.

Financial statements, of course, may serve many purposes: reports to stockholders of the steward-

(Testimony of O. Kenneth Pryor.)

ship of the management, preparation of income tax returns, fiscal policies, determinations as to whether dividends might be legal, costs under a contract such as this—any number of purposes. Obviously they can not serve all purposes equally well, so that it is almost impossible to divorce the question of purpose which you have in mind, because where you have a specific purpose you are obligated to be very much more accurate in a case such as you have described than if you were just keeping books for some other purpose.

Q. State whether or not indirect charges of the manufacturer which would have been incurred if the by-product had not been produced, but in lesser and unascertainable amounts would be included in the cost of manufacture or cost of production in the [603] situation that I last mentioned to you of the comparison of two yearly operations.

A. I do not think that an expense of that type belongs in the cost of production of a by-product. It can not be ascertained and it might go on of whether or not there was a by-product produced. Therefore I do not think that it should be charged to a by-product.

Q. I hand you herewith, Mr. Pryor, Plaintiff's Exhibit 15, which is an exhibit to the answer by the defendant to plaintiff's interrogatories in this case, and direct your attention to certain words and figures that appear in two columns and two purported comparative periods, the first being July 1, 1944 to June 30, 1945 and the other period from July 1, 1945 to June 30, 1946.

(Testimony of O. Kenneth Pryor.)

I might say to Your Honor that this is Exhibit 15. The witness Webster dealt with Exhibit E. Exhibit E, which Webster dealt with, had to do with the so-called second price increase. This particular exhibit, Exhibit F, has to do with the periods involved in the claimed third or last claimed price increase.

Q. Now, Mr. Pryor, taking the items appearing in subparagraph B of the exhibit which you have in your hand, please state whether or not in your opinion the items appearing in the left-hand column should or should not be included among the costs of production, the costs of manufacture of the by-product, keeping in mind for your information the notations and statements which [604] appear on the right-hand column opposite the particular item of cost set forth in the left-hand column.

A. The first item on the exhibit is described "Supervision," and the basis as shown is "Allocated." I do not believe that an arbitrary allocation of a thing like that results in a direct charge. Supervision, I presume, would go on whether or not there was produced by-product gypsum, and I do not believe that that type of thing belongs in here.

I might note that on the schedule there is no change in the item between the two periods, although I do notice that there is a footnote which indicates that in the first of the two periods 18 per cent apparently of supervision was allocated to supervision, whereas in the second period 26 per cent was allocated to supervision.

(Testimony of O. Kenneth Pryor.)

Mr. Kaapeke: To gypsum, you mean.

A. To gypsum. Excuse me.

Q. (The Court): Where is that?

A. May I point it out to Your Honor? There is no change in supervision as indicated for the periods, but in the first period they have allocated 18 per cent to gypsum and in the second period they have allocated 16 per cent to gypsum.

Q. (Mr. Bennett): What effect, if any, would that difference of percentage of allocation have in your determination?

A. None whatever as to the inclusion of the item. I do not believe it belongs in there at all. But, of course, if there is [605] a change in accounting basis or a change in method of allocation, it becomes rather arbitrary, it seems to me, which is a further reason why some other type of item might not be includable, in my opinion.

Q. Assuming that this item of supervision which you just mentioned was a charge which would have been incurred had no gypsum been produced but in lesser and unascertainable amount, state whether or not that would also be a separate and distinct reason for either including or not including the item of supervision.

Mr. Rosenberg: To which I object on the ground it assumes a fact not in evidence. Where is the basis for that?

Mr. Bennett: The basis is simply this, counsel: In your answer to the interrogatories, under 10G you state, "See Exhibit F," attached hereto. And

(Testimony of O. Kenneth Pryor.)

then you say, "None of the direct charges shown on Exhibit F would have been incurred if no gypsum had been produced. Indirect charges shown on Exhibit F would have been incurred if no gypsum had been produced but in lesser and unascertainable amounts."

Now, I assume from the very nature of the exhibit which you have referred to in your answer, which is in evidence, that this item of supervision is one of the indirect charges that you referred to, but wholly aside from that assumption, which I think we are entitled to draw, I am entitled to ask this witness as a basis for this question an assumption. In other [606] words, if the interrogatories themselves do not make it clear that the item of supervision is classed by you in relation to the statement which I have just read as not an indirect item as you mentioned it, I am at least, for the purpose of this examination, entitled to ask a question on the assumption that it is, and then the witness' answer will or will not be relevant in this particular, depending upon further facts as they are developed. We can not try our whole case, as Your Honor knows, in one question. Perhaps all this question can be resolved, counsel, by you answering my inquiry now of whether or not the item of supervision, paragraph B of Exhibit F, is one of the indirect charges which you mention in your answer 10G to the plaintiff's interrogatories being an indirect charge.

(Testimony of O. Kenneth Pryor.)

Mr. Rosenberg: I frankly do not know, Mr. Bennett.

Q. (Mr. Bennett): I will ask you, Mr. Pryor, according to your understanding, where an item is one that is allocated, would you consider that a direct or an indirect charge?

A. I would consider it an indirect charge.

Mr. Bennett: Very well. I would like the witness to answer my question.

The Court: Read the question.

(The Reporter read as follows:)

“Q. Assuming that this item of supervision which you just mentioned was a charge which would have been incurred had no gypsum been produced but in lesser and unascertainable amount, [607] state whether or not that would also be a separate and distinct reason for either including or not including the item of supervision.”

A. I think that would be another reason for excluding it from the cost of manufacture of the by-product gypsum.

Q. (Mr. Bennett): Take the next item, “Labor Operations.”

A. Labor operations has opposite the notation “Actual time card distribution,” which would lead me to believe that they had computed that based upon time cards, in which case I think it is direct and I believe it belongs in the cost of production of the by-product, and I assume in saying that that is the labor which is involved in the actual finishing of the by-product from the point of separation.

(Testimony of O. Kenneth Pryor.)

Q. How much of an increase in the comparative period, that is, in the year July 1, 1945 to June 30, 1946, is there over and above the preceding twelve month period, if any?

The Court: Is there any question about that labor charge, the allocation?

Mr. Bennett: No, Your Honor.

The Court: Why spend any time on that?

Mr. Bennett: I just wanted to have a computation here of the items that are agreed to, or which this witness feels should be included.

The Court: You can not get anything more definite than that, than the time card showing of the actual labor. I will [608] stand corrected if there is any question about that.

Q. (Mr. Bennett): There is a three cent increase?

A. There is a three cent increase in that item.

Q. The next item, "Labor Repairs."

A. The same notation is opposite it, and assuming that that was the labor for repairing machinery used in the finishing of the by-product from the point of separation, then I think that belongs in there. There is an increase in that item of four cents per ton.

Q. The next item, "Material Operations,"—and this is one item in which there is a detail which I think we should develop—what would you say as to that item?

A. It says, "Material Operations," which I presume means materials used in the direct manufac-

(Testimony of O. Kenneth Pryor.)

turing of the by-product gypsum. It says "On direct purchase and storeroom requisitions," and I think it belongs in the cost of production of the by-product. There is an increase of three cents in that item.

Q. Assuming that one cent of that increase resulted by reason of a change in accounting methods, then what would you say, Mr. Pryor?

Mr. Rosenberg: To which I object on the ground it includes a fact not in evidence.

Q. (Mr. Bennett): Assuming that in the second period one cent of that three cents was for an air compressor, which charge for the first period in comparison was carried under the [609] title of "General Plant Expense," what would you say in connection with the propriety of including that one cent charge for the air compressor in the second period, whereas in the first period it was charged to general plant expense?

Mr. Rosenberg: Same objection. You are apparently reading from something, but I am sure there has been no evidence up to this point of anything of that nature.

Mr. Bennett: Counsel, we will develop that. As I said before, I can't prove the whole case in one question.

Mr. Rosenberg: That is right, but it is up to you to have your foundation laid before you put a hypothetical question to the witness.

Mr. Bennett: All right, if you wish to take time to do that now.

(Testimony of O. Kenneth Pryor.)

Counsel, I will ask you if it is not a fact, to save time, that in the first period involved in this comparison presented by Defendant's Exhibit F to their answers to plaintiff's interrogatories, one cent of that claimed 3 cent increase during the second period, July 1, 1945, to June 30, 1946, involved a charge for air compressor, which in the previous period, the 1944-1945 period, had been charged as against general plant expense.

Mr. Rosenberg: I do not know. If you will tell me what source you are getting that information from, Mr. Bennett——

Mr. Kaapeke: Claude, I will state the source of it: [610] In my office Mr. Watt and you had a conversation. I was sitting at the same table. You turned to Watt, and the discussion was over this air compressor. You asked him if that change was made, and he said, "Yes."

You said, "Is that one cent?"

And he said, "Yes."

And if you do not care to stipulate to that, all right.

Mr. Rosenberg: If that is a fact,—frankly, I do not recall that. I do not doubt that it occurred if you say it occurred. However, I would submit this. Your Honor: If it was in another account in the prior period and you put it in a different account in the second period, then if you are going to take it out of the account, you should put it back in the account it was in in the previous period, according to their theory, so it would not necessarily record any change.

(Testimony of O. Kenneth Pryor.)

Mr. Kaapeke: That is what was done, saving for the moment the question of whether general plant expense should go in or not.

Mr. Rosenberg: I will withdraw my objection subject to your offer to lay the foundation later.

Mr. Bennett: We could stop this and call Mr. Watt.

Mr. Rosenberg: I have withdrawn my objection for the time being.

The Court: Let the witness answer the question.

(The question was read as follows:) [611]

“Q. Assuming that one cent of that increase resulted by reason of a change in accounting methods, then what would you say, Mr. Pryor?

A. I would say that the accounting methods should be the same in both periods, if you are going to compare the two periods, and I do not believe that a change in accounting method should be made where it results in increasing a price under a contract, or where you are comparing two periods, even if there is a contract.

Q. (Mr. Bennett): As to that item and assuming the correctness of your theory and reason, there would be, instead of three cents, allocated to increased cost two cents, is that correct?

A. That is correct.

Q. Take the next item, please, “Material Repairs.”

A. Material Repairs. That is apparently from the description on the exhibit based on storeroom requisitions and direct purchases, and so long as they applied to repairing things in the gypsum

(Testimony of O. Kenneth Pryor.)

operations directly, I would have no objection whatever to including them in cost of production. There was an increase in that item of 9 cents.

Q. The next item.

A. The next item is bittern. From what I have heard here before, I take it that is raw material which starts at the beginning of this plant, and I do not believe that it therefore has [612] a place in the cost of manufacture of a by-product.

Mr. Bennett: May I interrupt here? Your Honor has, for the purpose of accelerating this trial, which is a proper thing, stated that where matters do not involve an actual claim of increase for any period, we can skip that. The only reason I am mentioning this point now is that while this period there does not appear to be an increase in the charge of bittern——

The Court: There is a deduction.

Mr. Bennett:—there is a question in the final decision of this case as to whether or not bittern is a proper basis of cost, which will have to be determined by the Court, and the reason I asked that specific question of the witness was so that Your Honor will have such benefit as his testimony gives with reference to these disputed items.

Mr. Rosenberg: Then, Mr. Bennett, wouldn't it be proper—I presume the purpose of writing these figures on the board is to show the results of this witness' opinions. So to be consistent there should be another two cents on there, shouldn't there, because we gave you the benefit of the reduction in bittern cost, and he said that that is im-

(Testimony of O. Kenneth Pryor.)

proper. Bittern should not be included at all. Now, you do not want to take the benefit of that two cents according to this witness' testimony do you?

Mr. Bennett: I suggest we carry this 2 cents but you made your comment, counsel. The problem is not as simple as you are stating it. We will put on the board this item of bittern, 2 cents, we will put it down so there won't be any question of it.

Q. The next item of water, My Pryor.

A. There is no charge in that item. It is marked out on the side, "At cost measured." I presume it is used directly in that gypsum process and the finishing of the raw material, and I would have no objection to that item of expense being included.

Q. Next item, power.

A. Same thing can be said for power.

Q. Gas.

A. In the case of gas, for the same reason I would include it; there is an indication of one set.

Q. Fuel oil.

A. I cannot tell from looking at this statement whether there has been a change in accounting bases or not. There is a zero in the first column, and 1 cent in the second column. If it is a product which was introduced, that is a fuel which was introduced in substitution of some other fuel, and it was necessary to have them use it directly in the process, then I would have no objection to its inclusion, and it would show an increase of one cent.

Q. Next item, sulphuric acid. In considering that item I wish [615] you to consider and assume

(Testimony of O. Kenneth Pryor.)

that the sulphuric acid is added in the manufacturing process prior to the point in time of separation of the by-product in this case.

A. I should like to add to that assumption that if that was placed in there necessarily and solely for the production of the by-product gypsum: In that case I have two things to say about the item. First thing, I do not believe it belongs in there under those circumstances at all. In the second place, it would appear that they might have some change, there might have been some change in accounting method and the apparent increase that are simply the result of changes in accounting methods or bookkeeping increases, so to speak, I believe have no place in a comparison where you are trying to get down to unit cost comparing one period with another.

Q. Assuming that up until the period July 1, 1945, or from July 1, 1945, to June 30, 1946, the manufacturer had never charged or sought to charge any sulphuric acid to the cost of producing the by-product in question, but had charged it to some other product, how would that affect your answer?

A. Well, I should say that that would be a change in accounting basis and therefore would eliminate this item.

Q. Take the next one, the item "Overhead," and assume that the item Overhead involves costs which would have been incurred if no gypsum had been produced but in lesser and unascertainable amounts,

(Testimony of O. Kenneth Pryor.)

what would your answer be as to whether or not the [614] item of overhead appearing on Exhibit F should or should not be included in the cost of production or manufacture of the by-product, and whether or not any actual increases or advances in such cost should be considered for such comparative period.

The Court: On a labor basis? That item is on a labor basis?

Mr. Bennett: Yes, your Honor, if you wish that; I will follow that up.

The Court: That is the label on the item.

Mr. Bennett: No. What that means, your Honor, as I understand it, is that these——

The Court: Allocated on a labor basis.

Mr. Bennett: Allocated on a labor basis. In other words, the defendant claims that it is entitled to allocate this plant overhead for certain items for the Western Division and overhead for certain items in the New York office on a basis of applying the relation of the direct labor charge that they have for the gypsum industry as that bears to direct labor charge in some other operations, the details of which I don't know.

Mr. Rosenberg: Let's be fair, Mr. Bennett. If you are making a statement as to what the defendant's contentions are let's state it correctly.

Mr. Bennett: Well, you say it.

Mr. Rosenberg: Our contention is we are entitled to allocate [617] general overhead at the

(Testimony of O. Kenneth Pryor.)

Newark plant on the basis that the direct labor employed in processing the gypsum from the time it is separated from the bittern bears to the entire labor in the Newark plant.

The Court: That was my understanding.

Mr. Bennett: That is all right if that is your understanding. I understood your question to me was that this item of overhead included labor charge.

The Court: I said on a labor basis.

Mr. Bennett: Yes. Now, Mr. Rosenberg, is it not a fact that among the items of overhead charges that you include in this total as appearing in this Exhibit F to your answers to plaintiff's interrogatories, not only overhead for the operations of the plant at Newark are involved, but also overhead of certain items, certain items of overhead at your western division and your New York office?

Mr. Rosenberg: Oh, no. I will say the answer is "No," Mr. Bennett. I would say this, that considered as part of the overhead expense of the Newark plant is a portion of New York general and administrative expense that is allocated by the New York office to the various plants throughout the country by the Westvaco Chlorine Products Company, including Newark, but I did not want you to create the impression that the New York expense is allocated to the Newark plant according to the relation that the direct labor of both products should bear [617] toward each other because that is not true.

(Testimony of O. Kenneth Pryor.)

Mr. Bennett: Based upon the situation as outlined by the comments of his Honor and the comments of Mr. Rosenberg, Defendant's counsel, and myself, state whether or not the item "Overhead" as it appears on Exhibit F and any claimed increases appearing on that exhibit should be included in the cost of production for the purpose of this comparative period?

A. I do not believe that any part of it belongs in the cost of producing the by-product.

Q. You would therefore disallow any increase as claimed on Exhibit F for that particular item?

A. I would.

Q. The next item involves three items grouped together, taxes, insurance, and depreciation. I refer in connection with that particular item your attention to the items, the breakdown details of each of those items as appears on the first page of Plaintiff's Exhibit 18.

The Court: Taxes, insurance and depreciation.

The Witness: Yes. Taking the items in the order that they are on the exhibit which you have just handed to me, the first item is insurance, in which there is shown——

The Court: Taxes, isn't it?

A. In your copy, I believe—the exhibit you are looking at, your Honor, it is—— [618]

The Court: Oh, I see.

The Witness: I am looking at this and the first item is insurance.

(Testimony of O. Kenneth Pryor.)

The Court: Yes.

The Witness: In which there is shown a decrease of one cent per ton. As to insurance, we, of course, have to know, I believe, in the present circumstances, what type of insurance it was.

Q. Let us assume it is insurance on fire and other risks of property, both real and personal.

A. In the case of fire insurance, and in this particular instance I think there might be good reason for leaving it out on the theory that it represents a policy matter, the company has decided to assure itself against the risk of loss of capital, and I think there might be good justification for leaving it out, but I might say, Colonel Bennett, that in many companies it is included. I know of companies where it is excluded from cost of manufacture. I know of companies where it is included. Frankly, I wouldn't quarrel with the way it has been done here.

Q. If that insurance item bore a direct relation to the particular items of property, real and personal, devoted to the processing of gypsum after its separation, then you say you would not quarrel with it, although it is a matter that could or could not be included? [619]

A. That is correct. Of course, I do not think any insurance that does not relate to the particular properties used in this drying and grinding or the by-product has any place in the cost of the product, or the by-product.

(Testimony of O. Kenneth Pryor.)

Mr. Rosenberg: I will move that go out; there is no basis for any such statement.

The Court: It may go out.

The Witness: I beg your pardon.

Q. (Mr. Bennett): Take the next item, please, Mr. Pryor.

A. The next item is labeled "Taxes on real and personal property." There is no change during this period.

Q. Assuming there was a change during that period, what would be your view with reference to the propriety of including such an item, and if there are any conditions for that what conditions would there be?

A. I think that goes to a basis of determining as to the item, itself. I would have no objection to including it in cost of production of a by-product if it related to the properties that are used in the finishing of that by-product. If it can be determined, for example that the assessor had valued those particular properties in the plant at X dollars, then I would have no objection to applying the applicable tax rate to those X dollars to determine how much should be included in the cost of production of gypsum.

Q. Take the next item. [620]

A. Depreciation shows a decrease in the cost per ton of 2 cents in this period. As to whether or not depreciation belongs in here as cost of manufacture of the by-product I would say that if it

(Testimony of O. Kenneth Pryor.)

applies to the particular facilities used in the finishing of that by-product it would be so, but I would like to qualify that to this extent, and that is that I believe that where you are comparing two accounting periods and reducing each result to a unit of production basis, that you would be justified in eliminating any other type of allocation of depreciation other than a unit of production method of computing the depreciation.

Q. What about the next item, Inter-departmental charges?

A. Are you still referring to the——

Q. No; I thought that covered taxes, insurance and depreciation. Haven't you?

A. Yes, I have. I see you are going now back to Exhibit F.

Q. Inter-departmental charges.

The Court: At cost.

Mr. Bennett: At cost. There is no apparent increase or decrease or decrease as to that item, but assuming that there was an increase, should that item be considered or included as cost of production?

A. Will, I notice up at the top of this exhibit, or further up on the exhibit there was "Water at cost measured." I do not know what the nature of this inter-departmental charge for water at cost is; if it represented an item of water, comparing actual cost that was used solely in the production of [621] the gypsum by-product I would have no

(Testimony of O. Kenneth Pryor.)

objection to including it, but if it represents some arbitrary allocation of overhead, more or less, I wouldn't think it would be includable.

Q. What about the last item, Shipping expense? In that connection, please keep in mind the explanation that appears on the right-hand column of Exhibit F, and also assume, Mr. Pryor, that 2 cents of that claimed cost of 28 cents per ton during the latter period involved indirect charges which would have continued if production of gypsum, or if no gypsum had been produced but in lesser and unascertainable amounts?

A. Perhaps I can save a little time here——

Mr. Rosenberg: Just a minute. I suggest, Mr. Kaapecke, you do not anticipate the witness by writing on the board.

Mr. Kaapecke: Oh, pardon me.

Mr. Bennett: Go ahead.

The Witness: I might save a little time if I explained first that shipping expense is ordinarily not considered manufacturing expense, but I understand that it is not in contest here, and it is agreed that shipping expense, because of the wording of the contract, is to be included, nevertheless. With that preliminary I would say that the actual out-of-pocket expense over in the by-product plant of shipping the gypsum would be includable for this purpose. Now, as to the indirect items that you mentioned of 2 cents, I do not believe that such indirect items should be included. There is an [622] apparent increase here on the face of the exhibit of

(Testimony of O. Kenneth Pryor.)

7 cents, so that if 2 cents was indirect, I would say there could only be an increase in this particular item of 5 cents.

The Court: Is there any hope of concluding with this witness?

Mr. Bennett: I think that is all, your Honor.

The Court: It is after 12 o'clock. We will take a recess until 2 o'clock.

(A recess was thereupon taken until two o'clock p.m.)

Thursday, December 18, 1947, 2:00 o'clock p.m.

Mr. Bennett: I have one or two questions.

O. KENNETH PRYOR

resumed the stand.

Direct Examination (Continued)

Q. Prior to the noon recess, we were discussing and you were giving your opinion with reference to the items of cost bearing on Exhibit F of the defendant's answers to the plaintiff's interrogatories, and we completed, as I understand it, all the items appearing on that page. Will you state for the record, Mr. Pryor, the total amount of actual increases or increase in the cost of production of gypsum in the 1945-1946 period, if any, over the preceding twelve month period?

Mr. Rosenberg: That is based upon the same assumptions that the witness has been indulging in throughout his testimony?

Mr. Bennett: That is correct, Your Honor, and also on the assumptions that the figures and state-

(Testimony of O. Kenneth Pryor.)

ments contained in Exhibit F of the defendant's answer to our interrogatories are correct.

A. I think that the increase in the cost of production of the by-product gypsum for that period which would be proper under the contract, would be 25 cents.

Mr. Rosenberg: Just a moment. I am going to ask that that answer be stricken. I did not understand that this witness was to construe the contract.

Mr. Bennett: I did not say anything about the contract. [623]

The Court: He could not control that answer.

Mr. Bennett: Disregarding your understanding of the contract, but based upon opinions and views that you have previously expressed and upon your consideration of each of the items of cost set forth on Exhibit F of the defendant's answers to plaintiff's interrogatories, state the total amount of the actual increase, if any, of the cost of production for the period 1945, July 1, 1945, to June 30, 1946, over the preceding twelve month period.

A. 25 cents per ton.

Q. If these items of depreciation, insurance and bittorn are proper to be considered as actual costs or as costs of production or manufacture of gypsum and allowable as such, what would be the total amount of increase in the period mentioned in the preceding question?

A. It would be 25 cents less 5 cents for those three items, or 20 cents per ton.

(Testimony of O. Kenneth Pryor.)

Q. Mr. Pryor, you have testified that you eliminated this item as stated as overhead in Exhibit F to defendant's answers to plaintiff's interrogatories, and assuming again that the problem is the comparison between the two year-periods in question that I have just mentioned, the purpose is to determine any actual advance in the cost of manufacture of gypsum, and such determination is one in which not only the manufacturer is interested but also the purchaser—in other words, the rights or obligations [624] of both the manufacturer and the purchaser of the gypsum are to be affected by such determination—state the reason or reasons, if any that you have, why you would exclude such item denominated, "Overhead."

Mr. Rosenberg: Do I understand that the witness is testifying that it would be proper to include overhead, that it would be in accordance with good accounting practice to include overhead for a by-product if no one other than the producer were affected?

Mr. Bennett: No, I do not understand him to say that at all, counsel, but I am asking this question, as I am entitled to ask it, from an accounting point of view where the comparison——

The Court: It is rather involved, and I suggest that you break it up by asking direct questions so that I may be able to follow the testimony.

Mr. Bennett: I will do that. I thought I had already asked the direct question.

(Testimony of O. Kenneth Pryor.)

The Court: I do not know whether you are conscious of it. It may be myself. In asking these questions, they become so involved, I should think if you would break them down in some fashion so I could follow them directly, it would be helpful.

Mr. Bennett: I will have to repeat a little bit.

The Court: That is all right.

Q. (Mr. Bennett): You have already stated, Mr. Pryor, you [625] would disallow this item denominated overhead in defendant's Exhibit F to the defendant's answers to plaintiff's interrogatories. You disallowed that item, as I understand it, both from the point of view of being a proper allowance for inclusion in the cost of a by-product, and you also disallowed it, as I understand it, with reference to the specific problem of the comparison of cost to determining any increase between these two periods mentioned in Exhibit F, is that correct? A. That is true.

Mr. Rosenberg: I am not conceding that to be true by not stating anything. I do not think the witness has said that if it was proper to include overhead in the first period, it would not be proper to include it in the second period for comparative purposes. He has not said that.

Mr. Bennett: I did not intend to indicate that he said that, counsel. I think both of your comments were not germane to my questions at all.

Mr. Rosenberg. All right.

Mr. Bennett: And it tends just to confuse.

Q. For the purpose of comparison of those two year-periods and for the purpose of determining

(Testimony of O. Kenneth Pryor.)

what actual advance, if any, in the cost of manufacture for the latter year period as compared to the first year period, there is, why would you disallow the item embraced in this classification of overhead as appears on Exhibit F of the answer to the interrogatories? [626]

A. I think that in the case of a by-product it has no place there. If you inject the other thought of another party involved it may be affected by your determination. It accumulates an error that you might make if you include it, because as you look at overhead in relation to a price fixing, then you must, of course, remember that by increasing the overhead in one period, by spending more money and decreasing it in another period by spending less money, you get an increase which, if you reverse the process again and again and again, it accumulates and accumulates. Now, that just does not make to me good business sense from an accounting point of view to do that, because, after all, a business man, when he looks at a by-product he thinks of it in terms of out-of-pocket. That does not mean overhead. He looks at it this way: If I produce a by-product my direct expenses are 10 cents and I can sell it for 11, I can make a cent. But if he allocates overhead and a lot of other expenses that would go on whether he made the by-product or not and he finds it costs 12 cents or 2 cents of overhead added to that, he would say, "Well, I won't make the by-product." And that does not make business sense, because by not making it he would lose a penny.

(Testimony of O. Kenneth Pryor.)

Q. State whether or not there is a greater or lesser reason or purpose in excluding such items of overhead as we have discussed here in your testimony in the case where not only the manufacturer is concerned with his cost accounting, but the purchaser [627] of the by-product is concerned with the amount of any actual increase in such costs of manufacture?

A. Well, I would answer that question this way: In computing the cost of manufacture of a by-product, I do not believe that good accounting would permit those things being charged, even if no one else were concerned, but if somebody else was concerned, I think it becomes imperative that he eliminate them.

Q. And why do you consider that it becomes imperative to eliminate them as costs of manufacture upon which any price increase would be based?

A. I think it is for the general reason that it does not fall in the case of manufacture of by-product, according to my original definition, but to put them in in the case you just described would give the seller, it seems to me, the power to affect the price—I do not like to use the words “legitimately” or “illegitimately” because I do not believe that that is necessarily the correct way to put it, but he would have certain powers of affecting the contract that I do not believe he should have.

Q. Would the fact that the manufacturer was willing to or did allocate such indirect or overhead items on a labor basis make any difference? That is,

(Testimony of O. Kenneth Pryor.)

would it make proper the inclusion of indirect and overhead charges?

A. I do not think that the basis of allocation is of the essence here. It is whether it should go in in the first place or not. I can think of a situation, for example, on the allocation point [628] where in the production of the principal product perhaps there is relatively little labor. It is a by-product process, and where the finishing of the by-product might involve a great deal of labor, and even assuming, which I do not for a minute assume, that overhead items should be allocated in some way to a by-product, certainly a direct labor basis would not be a proper basis under these circumstances.

Q. Assuming a situation such as a manufacturer of a by-product, gypsum, where there is a primary product, magnesium oxide, produced, whereas at the beginning, say, of any period of operation, the first year or so of its production, a great deal of labor was used in the production of the magnesium oxide, the primary product, but a change was made where in the place of labor, labor saving machines were employed, but so far as the production of gypsum was concerned, of by-product, the amount of labor that was used relative to the production continued on without substantial change; what would you say as to such a situation as that?

Mr. Rosenberg: To which I object on the ground it assumes facts which are completely the figment of counsel's imagination. There is not an iota of evidence in this record to sustain any such ridiculous

(Testimony of O. Kenneth Pryor.)

assumption for this witness to indulge upon. You can go, Mr. Bennett, to the limit where all of a sudden there was no labor for gypsum and ask him what the result would be, and what materiality would that have in the determination [629] of this case?

Mr. Bennett: Your Honor, I will concede that I am assuming a situation, but I think the assumption of that situation is definitely legitimate for the purpose of laying a foundation of the witness' views. He has already stated that the mere fact that allocations are made on a labor basis would not in his opinion give validity to such allocations. Now, this question was directed by way of a possible illustration. It might be applicable or not. That is for the witness to determine so far as his testimony is concerned.

Mr. Rosenberg: Oh, no, it is not for the witness to determine whether there is any foundation.

The Court: Counsel indicates you are assuming a fact not in evidence. There is no evidence in this case that embodies anything in your question.

Mr. Bennett: No, but a situation of that kind, if Your Honor please, may be used for the purpose of illustration.

The Court: I understand.

Mr. Bennett: And I am frank to confess that there is no evidence, so far as I know, that there has been a complete change in the method of manufacture of magnesium oxide. There have been some bookkeeping changes. They now charge, for ex-

(Testimony of O. Kenneth Pryor.)

ample, sulphuric acid, against the by-product. We need not go into that phase of the matter now, but I wanted to illustrate, if possible, situations that would give graphic [630] illustrations to what the witness is talking about, that the mere fact that items which are not ordinarily considered included in the cost of manufacture, do not become valid or appropriate merely because they are allocated on a labor basis.

Q. (The Court): Do you understand the question? A. Yes, I do.

The Court: You may answer it.

A. Again I would like to repeat that I do not think that any part of it would belong in the by-product, but if we assume that that would be the basis we should go on, then I think [631] those allocations should be made on a realistic basis and one which conforms to facts, and if there had been a substantial change in relative labor, if they started off on that basis and it was proper at the beginning, then I think it would call for a change in the basis of allocation.

Q. (The Court): What do you have in mind when you say a realistic basis?

A. One that conforms to what a reasonable business man and an accounting looking at it from that point of view would adopt. Accounts, Your Honor, are utilitarian to this extent, that they must have some semblance of business reason back of them.

The Court: Very well. Proceed. Is that all from this witness?

(Testimony of O. Kenneth Pryor.)

Mr. Bennett: Yes, Your Honor.

The Court: Proceed. Let us get along.

Cross-Examination

Q. (Mr. Rosenberg): Mr. Pryor, first, to go into something that was right at the end of your testimony, you were speaking of overhead and you said the reason you did not think that should be included in the cost of production of a by-product is because it would rest within the power of the purchaser, of the manufacturer, rather, probably to jockey his overhead expense up or down in different years that might be used for a comparative basis. Was that the essence of your testimony?

A. No, I do not think so. [632]

Q. What did you mean?

A. The essence—that was based upon an assumption which was given me. The essence of my testimony I believe has been that overhead should not be charged to the by-product.

Q. And then you were asked, “Well, now, if the cost of production of the by-product to the manufacturer is going to affect a purchaser of that by-product, is there more reason for the opinions that you have expressed?” And I believe you said yes, and then you explained why, didn’t you?

A. I merely said,—I think I started off my remark by saying, “I do not believe that it belongs in at all.”

Q. I understand that. Now, will you tell me what you told Mr. Bennett when he said, “Well,

(Testimony of O. Kenneth Pryor.)

now, if somebody else is going to be affected by that cost of production, do you think that that is all the more reason for not including that?" Do you remember that? A. I remember.

Q. And you said yes?

A. No, I didn't say "yes" in so many words. I said this—

Q. (The Court): In substance and effect, if I followed your testimony, it was that. If I am in error, you may correct me.

A. Yet me restate the thing.

Q. Yes.

A. I stated I did not think it belonged in the cost of [633] production of a by-product at all. If by some reason it should be under any theory, which I do not know what theory it could be, but if it should be, certainly that would have an effect on it, just as it would have an effect on the price of the major or primary product.

Q. (Mr. Rosenberg): And then didn't you say something about the fact that the overhead might be up in one year and down in another year, and therefore you would get what in effect would be a fictitious result? You did not use those words, but isn't that the meaning that you intended to convey?

A. I did not mean to convey it with relation to the by-product necessarily.

Q. Let me ask you this, Mr. Pryor: You will concede, won't you, that ordinarily overhead ex-

(Testimony of O. Kenneth Pryor.)

pense is considered a proper item in the cost of production of a manufactured product?

A. Primary product?

Q. Yes, or a co-product.

A. Oh, I would like to state there that when you say overhead, and I answer yes, I mean manufacturing overhead, not general and administrative overhead.

Q. All right, I am using overhead in the same sense that you used it in your testimony.

A. I just wanted to make sure we understood each other.

Q. Using it in that sense, you will concede in respect to joint products, co-products or by-products, overhead expense is [634] properly included in determining cost of production?

A. Manufacturing overhead, yes.

Q. And that is true whether the manufacturer has a contract to sell that product to somebody and the price is to be determined according to the cost of production or not, isn't that true?

A. That is right.

Q. And so the contract and the fact that a third party might be affected has nothing to do with it, does it?

A. Not as far as by-product accounting is concerned.

Q. Let me ask you, have you ever been to this plant in Newark?

A. No, sir, I have not.

Q. So you do not know anything about their

(Testimony of O. Kenneth Pryor.)

processes except what you have learned in court here, is that right? A. That is true.

Q. And you have been in court every day since this case started, have you not?

A. I think I have been in court all the time.

Q. All the opinions that you have expressed in your testimony were based upon the assumption that gypsum for accounting purposes is a by-product, is that true?

A. If I understand you correctly, those assumptions which I have made as to how accounting should be treated, it is in relation to a by-product.

Q. In other words, you have assumed throughout your testimony [635] that gypsum is a by-product for accounting purposes?

A. I was referring to it in that sense.

Q. And you are expressing no personal opinion of that yourself, are you?

A. I have not expressed one.

Q. No. In other words, you do not know, at least you have not expressed an opinion, and counsel did not ask you to, as to whether or not in your expert opinion, and in light of all the circumstances relating to the operation of this plant and everything else that you would have to know in order to arrive at an intelligent conclusion, whether or not gypsum is in fact a by-product for accounting purposes?

Mr. Bennett: That is argumentative, if Your Honor please.

The Court: The objection will be overruled.

A. I was not asked, as I recall it, whether in my opinion it was a by-product.

(Testimony of O. Kenneth Pryor.)

Q. (Mr. Rosenberg): Tell me if I am correctly stating what you stated in your direct testimony, that in determining cost of production of a by-product, you should include only those necessary expenses directly and solely attributable to its production and of which you can ascertain the amount with exactitude, is that right?

A. I think that is the way I expressed it.

Q. Let me ask you on what authority you make that statement. What is the basis for that expert opinion? [636]

A. I would say long experience in the profession, seeing a great many instances of account for by-products.

Q. I mean that particular language that you used. Where did you get that from?

A. The words themselves?

Q. Yes. Those are original with you, are they?

A. I do not know exactly what you mean originally with me, but I believe that that is my own definition.

Q. Let me ask you, can you refer me to any text writers or any papers or treatises by persons either being or purporting to be accounting authorities that would sustain your view that where you elect to determine the cost of production of a by-product, it is improper to include any overhead expense or indirect charges? Can you refer me to any authorities on that?

A. I do not have any specifically in mind, but I am sure there must be many like that because I

(Testimony of O. Kenneth Pryor.)

have read a good deal about accounting matters in my life and I have seen a good many [637] instances, and that is the way I have always looked upon it.

Q. You indulged in some preparation for your testimony in this case, didn't you?

A. I talked over a good many things.

Q. Did you go into your library to see if you could find anything on the subject?

A. The only thing which I really tried to find out was I wanted to check my ideas of the definition of a by-product.

Q. That is all you looked up?

A. I looked for other things but I did not immediately pay attention to the mechanical procedures, because I knew them so well. I have seen so many things on that subject, of course.

Q. But you can't recall any at this moment?

A. Specifically I would not want to say, yes.

Q. What is that?

A. I said, specifically I would not want to say.

Q. In preparation for your testimony in this case, didn't you go into your library and see if you had any works on by-products accounting?

A. I have a very limited library space for accounting books in my room and I did not go out of it for the purpose.

Q. Didn't you, Mr. Webster and Mr. Draewell collaborate for the purpose of your testimony in this case?

Mr. Bennett: I object to that question as in-

(Testimony of O. Kenneth Pryor.)

definite and uncertain. What do you mean by collaborate? [638]

Mr. Rosenberg: I will make it more certain.

Q. Didn't you, Mr. Webster and Mr. Draewell confer together and discuss the subject and discuss the testimony that you and each of you were to give in this case?

A. We conferred with each other. I don't know what you mean by discussing the testimony.

Q. Did you all agree that you were all going to state that in determining the cost of production of a by-product you should include only those necessary expenses directly and solely attributable to its production and of which you can ascertain the amount? Didn't the three of you get together and agree that that is what would be your opinions in testifying in this case?

A. We had no agreement. We discussed that definition and all of us felt that it met the case.

Q. And that probably explains the fact that you have all used precisely the same language, does it? A. I would not be surprised.

Q. In the course of your discussions, did any of you come up with a reference to any paper or treatise or authority that would support your view?

A. I can only answer that I did not. I do not know whether the others made references or not.

Q. At least in the course of their discussions with you they did not refer to anything, did they?

A. They did not.

Q. You have been sitting here ever since this

(Testimony of O. Kenneth Pryor.)

case started. You heard me when I was questioning Mr. Webster and Mr. Draewell, refer to the official publication of the National Association of Cost Accountants, didn't you?

A. I heard you refer to that book. I did not know it took on an official status.

Q. You know what the publication of the National Association of Cost Accountants is, don't you?

A. I do not know them all. I know their general publications, certainly.

Q. And you heard me mention this particular one, didn't you? A. Yes.

Q. A couple of days ago?

A. If that is the one you have in mind—the 1920 edition or something?

Q. You know that there is at least this authority on that subject? A. I do.

Q. But you have not troubled to look at it?

A. I haven't, and I do not know that I consider it an authority.

Q. You would not know until you read it, would you?

A. No, I would not. That is why I say I do not know whether I would.

Mr. Bennett: Apparently you have the only volume of that [640] in San Francisco, counsel. I have been looking through the libraries and every place I could find, including a lot of accounting offices.

(Testimony of O. Kenneth Pryor.)

Mr. Rosenberg: Well, I do not think anybody looked very hard.

Mr. Bennett: There is only one firm I could find and they said they had loaned their copy to a lawyer the other day.

Mr. Rosenberg: That is where I got it from.

Mr. Bennett: McLaren Goode & Company.

Mr. Rosenberg. No.

Mr. Bennett: But I defy you to find another copy in town.

The Court: You do not contend this is the only copy in town, do you?

Mr. Bennett: I have had the libraries searched, the Mechanics Library, the City Library, and my secretary has called a number of accountant firms. We finally found one firm who had it, and when they looked for it they said they turned it over to a lawyer the other day, and apparently this is the one.

The Court: It indicates the energy counsel has put in this case.

Mr. Bennett: He got the right one.

Mr. Rosenberg: I might say I got it the first time I inquired for it, and from the only source of which I inquired.

The Court: I am so limited on these matters myself, even [641] to discuss them, I felt surely there must be some treatises, texts on cost accounting.

Q. Aren't there? A. Yes.

The Court: The witness said there are.

(Testimony of O. Kenneth Pryor.)

The Witness: Yes, there are books on cost accounting, but usually the subject of by-product accounting is not treated very extensively in them. They are written for students and that sort of thing.

Mr. Bennett: When I said to Your Honor there wasn't any, I was thinking of this volume. This is the one I have looked high and low for and could not locate. Whether there are others I do not know.

Q. (Mr. Rosenberg): Did you ever read "Basic Standard Costs" by Eric A. Camman?

A. No, I have not.

Q. Have you ever heard of Mr. Camman?

A. Yes, I have.

Q. He is recognized as an authority on cost accounting?

Mr. Bennett: If Your Honor please——

Mr. Rosenberg: I am not reading anything.

Mr. Bennett: Wait. I want to repeat the objection I made the other day. This is not proper cross-examination. I can cite the Davis case and McBain——

Mr. Rosenberg: I just thought if he had read it, I would [642] refer to it.

The Court: If it was not admissible for any other purpose, it would be admissible for the purpose of testing this witness' testimony, would it not?

Mr. Bennett: The courts have not considered it proper cross-examination, Your Honor, on various occasions.

(Testimony of O. Kenneth Pryor.)

The Court: Forgetting, for a moment, cross-examination; qualifying the witness as to the weight of his testimony.

Mr. Bennett: The Courts say that that is not the proper way to do it.

The Court: I would like to be straightened out on that.

Mr. Rosenberg: I think it is proper, if the Court please. There are some decisions that hold that unless a witness has referred to a particular work in his direct examination, it is improper to read excerpts from the work to him on cross-examination.

The Court: To read it, but keeping in mind that the witness qualifies as an expert, any examination in relation to his testimony and his ability to testify should be measured and it goes to the weight of his testimony, it seems to me. If I am in error, I should like to be corrected.

Mr. Rosenberg: I think that is the rule. As I say, I think there are cases both ways.

The Court: I have followed that rule, and if I am in error I would like to be corrected. [643]

Mr. Rosenberg: I know in a comparatively recent case decided in this Circuit by the Circuit Court of Appeals, that was held to be proper cross-examination.

Mr. Bennett: What case is that?

Mr. Rosenberg: American Whaling Company v. Christensen, 93 Fed. Sec. 17.

Mr. Bennett: The vice of the matter, Your

(Testimony of O. Kenneth Pryor.)

Honor, is that it opens the door too wide to get before the Court, in unsworn hearsay form, evidence or the effect of evidence that is not evidence. I read to Your Honor yesterday the decision of the Supreme Court of the United States in the case of *Davis v. United States*:

“After a witness has once qualified himself as an expert and given his own professional opinion with reference to that which he has seen or heard, or upon hypothetical questions, it is ordinarily opening the door to too wide an inquiry to interrogate him as to what other scientific men have said upon such matters or with respect to the teachings of science thereon or to permit books of science to be offered in evidence.”

McBain has many comments on that and cites numerous cases. I do not have in mind specifically this decision that counsel mentioned, but I think Your Honor can see the harm that is done by reference to books.

The Court: I can see the abuse of it, but when a witness [644] is called as an expert witness——

Mr. Bennett: It is proper to inquire into the witness' expert basis, his training, the things that serve to qualify him or not as a witness; but Your Honor and I know in the field of science, even in the fields of law, we have people who write things in which there is a complete divergence of opinion. In fact, we will find quite frequently reports of the Supreme Court decisions 5 to 4, and we find our own District Courts of Appeal sometimes deciding

(Testimony of O. Kenneth Pryor.)

one division the case one way and the other, another, and we find in law review articles entirely divergent points of view stated, and to pick out at random here and there a statement or a book or a text or something and ask the witness, "Did you read this? This is what this says," the effect of the thing is, as the Supreme Court said, to open the door too wide to improper evidence. I think the basis for my objection is apparent from what I have said. I have no objection to counsel interrogating this witness as to his qualifications as an expert, but I do not think it is proper to do so by this particular method.

The Court: What testimony is in this record that is an abuse of the Supreme Court case that you cited?

Mr. Bennett: Your Honor has read into the record—not Your Honor, but counsel has read into the record certain statements contained in a text or a book that counsel referred to here, the same book that I told Your Honor I have searched [645] high and wide, but, so far as I know, there is only one here in San Francisco.

The Court: The question was did he agree with that.

Mr. Bennett: That is not proper cross-examination. That is what the Supreme Court has said in the Davis case and Courts have constantly said that. That is what the Courts said here. It is not proper on cross-examination to ask a witness whether——

(Testimony of O. Kenneth Pryor.)

The Court: Let us see what subject matter they were dealing with. What was the factual situation in that case?

Mr. Bennett: The expert in that case was a doctor. He was expressing a medical opinion.

The Court: Yes.

Mr. Bennett: Then counsel for the defendant starts to cross-examine him, or, as the Court said, to interrogate him as to what other scientific men had said on the same subject, and the Supreme Court said that that is not proper.

The Court: If you begin there, it would not be proper, but that is not the whole case. Hand me that case and proceed with this case. I will consult that.

Mr. Bennett: I do not want to prolong this trial. I can give Your Honor other citations, too.

The Court: I have no doubt if you search the record and the books you can get a hundred cases on each side of any question we discover from time to time. [646]

Mr. Bennett: This is a well established rule.

The Court: I do not disagree with you in part.

Mr. Bennett: Here is a leading case on it.

The Court: This is a death case:

“After qualifying as an expert I am giving his professional opinion in reference to that which he has seen or heard and questioned on behalf of defense on cross-examination, ‘You think from your experience with him, from your conversations with him, that he killed the man because he threatened his life.’ ”

(Testimony of O. Kenneth Pryor.)

That was the question in this case where you had——

Mr. Bennett: Yes, your Honor. That involves an expert opinion on the ground the doctor was a psychiatrist, or purported to be one.

The Court: Yes.

Mr. Bennett: He expressed the opinion that the acts of the individual in his mind as a psychiatrist indicated the commission of the offense. He was sought to be cross-examined by references to what some other psychiatrist may have said in some book or record as to whether or not those physical indications would be sufficient to warrant the scientific deduction that the witness is stating. The court said that is not proper.

The Court: In a criminal case under the same circumstances I would base this ruling in this case.

Mr. Bennett: Here is the general rule McBain speaks of, he is our author on Evidence in this State. Your Honor is quite familiar with him. Turn to page 293, Section 211. [647]

The Court: This is McBain on Evidence. You must have another edition.

Mr. Bennett: Here it is, your Honor.

The Court: This is an ancient edition, I am afraid.

Mr. Bennett: Here is another edition. He is the professor of law at the University of California. He has written that book.

The Court: Well, I have no quarrel with this Professor McBain at all.

(Testimony of O. Kenneth Pryor.)

Mr. Bennett: As he states there, rather citing this Bailey case, it is proper if the witness bases his opinion upon some scientific book to cross-examine him about that book; no question about that, but this witness said he had never read this book nor heard of it, has not got it. Besides, as part of his cross-examination that book cannot be waved around and he be asked whether he agrees with what that book says. That clearly falls within the provisions——

The Court: Is there some comment you wish to make before I make an announcement, myself?

Mr. Rosenberg: There is nothing before the court. I am enjoined from any discussion. I have not asked a question, your Honor.

The Court: I am satisfied, I think, from my personal experience with you you conduct yourself in a manner that a seasoned, a well-seasoned lawyer would. You sit down there and let [648] somebody else perform for you. If there is any question about it I wouldn't have any hesitancy in striking out the testimony in relation to any testimony that went in in relation——

Mr. Rosenberg: That's right, your Honor. If there is any doubt about it I wouldn't object.

The Court: You see, lawyers have as much difficulty and get into the same positions that cost accountants and expert witnesses on cost accounting books do. I am free to say there is a difference in what the courts do. Here you have witnesses in relation to cost accounting and right from the testi-

(Testimony of O. Kenneth Pryor.)

mony in this record it shows that we are not dealing with an exact science.

Mr. Bennett: I don't know what difference there is, your Honor. I have not noted any substantial difference.

The Court: Well, maybe it is me, and my limited experience.

Mr. Bennett: Your Honor may have in mind what the witness Webster said, that he did not deal with the term "overhead" specifically, it was what was included in overhead that he objected to. I think if we go down to the point where it is time to argue I will show there is not any difference at all. He says he just does not treat it upon the terminology of overhead; some items may be listed as overhead which in fact are direct charges, but I don't recall any substantial——

The Court: Well, you won't be taken by surprise before [649] we get through. There will be a definite conflict; you are anticipating that, I take it.

Mr. Bennett: Yes, I suppose so. I have had experience in the past when we have had experts on both sides of a question, your Honor.

The Court: I have seen it frequently on both sides in dozens of cases, counsel for the plaintiff calls his witnesses and you may expect a conflict when the defense calls his. That is the reason they were called.

Mr. Bennett: Well, I don't know that to be a fact, that the defendant has any experts who will be any different from ourselves. My supposition——

(Testimony of O. Kenneth Pryor.)

The Court: You might expect anything from counsel. I don't know any more than you do about it.

Mr. Rosenberg: I was going to say, your Honor, that in this American Whaling case, decided in this Court, the court——

The Court: An opinion by whom?

Mr. Rosenberg: Denman, Stephens and Healy. This is what the court said:

“Passages from text-books were read to a witness on cross-examination and defendant assigns this as improper. This was permissible to test the knowledge, accuracy, and credibility of the witness,” as an expert witness.

The Court: To determine the credibility of the witness. [650] The test you give to the witness, I think perhaps for a limited purpose.

Mr. Bennett: What counsel has just read is nothing but a dictum statement and is not a decision by the court. I have not had a chance to read this opinion. My associate just brought it in.

The Court: In any event, you have an objection to that line of testimony and both sides will have an opportunity to present it.

Mr. Bennett: Yes, your Honor. I understand my objection runs to all of this.

The Court: To all of it.

Mr. Bennett: Without necessarily repeating it.

The Court: No necessity for repeating it. The only thing, you will be comforted by a record, and you have a record.

Mr. Bennett: Well, as I said to your Honor be-

(Testimony of O. Kenneth Pryor.)

fore, I, perhaps, am a very poor one trying a case with a record; I would rather try it with a judge who is going to decide the case in the trial court.

(Discussion off record.)

The Court: Proceed, now.

Q. (Mr. Rosenberg): Mr. Pryor, reverting again to this expert opinion of yours derived, as I understand it, solely from experience, is that it?

A. I wouldn't say solely from experience, but studies during the [651] term of 20 or 25 years.

Q. Have you ever had any experience in cost accounting for a chemical plant that starts with a common raw material and produces a number of products from that raw material, in setting up the accounting for such a chemical plant?

A. When you say in setting up the accounting, do you mean familiar with the accounting system?

Q. Familiarizing yourself or having gone into the cost accounting.

A. Of that type of plant?

Q. Yes. A. Yes.

Q. What plant was that?

A. It is a plant that is owned by one of my clients, it is a large plant.

Q. What do they make?

A. They make—the end product is chiefly ammonia.

Q. What else do they make?

A. Well, that is, practically speaking, the only one of the end products, although they do have another product which is a by-product.

(Testimony of O. Kenneth Pryor.)

Q. What is that?

A. Perhaps I can best tell you by describing the by-product. In the process of making this ammonia they first must produce hydrogen—I hope I am not getting over my head in chemistry, [652] here because I may very well be.

The Court: You will have a lot of company.

The Witness: They first introduce natural gas into the plant and the natural gas is, I believe, heated and subjected to pressures and in that process they produce the hydrogen, which in turn is used to produce the ammonia. When they heat and treat the natural gas it removes by precipitation, or some process similar to that, carbon, and the carbon is processed into briquets and sold for fuel, I believe it is. Of course, the carbon coming off there represents to them the by-product from this main and primary object which they have in mind of producing the ammonia.

Q. (Mr. Rosenberg): That carbon is produced by the heating of the mother gas, is that it?

A. I would rather not specify.

Q. At any rate,—maybe I am becoming too specific—have you ever had any experience in setting up the cost accounting for a chemical plant for a number of products out of a common material where any one of the products was covered by a contract that required you to determine the cost of production in order to determine the sales price of the product?

(Testimony of O. Kenneth Pryor.)

A. You mean the contract for a by-product?

Q. Well, if you want to call it a by-product, all right.

A. I believe the case I had that comes to that particular analogy would be in the case of the Oil Refineries who during [653] the war furnished a product, I believe it was known as butalenes, I believe they called it butalenes, and it was taken into a portion of a plant and made into a butadiene, and the butadiene is a raw product used in making artificial rubber, synthetic rubber. In that case the butalenes were in the making of a by-product and the refining company had a contract with Rubber Reserve Corporation, to pay them for the butalenes that they put out.

Q. And was the price dependent upon the cost of production?

A. To go on further——

Q. No. Can't you answer just "yes" or "no," was it or was it not?

A. The price of the butalenes, or the whole operation?

Q. The butalenes.

A. I believe it was based on a price per unit with some sort of an escalator clause which was tied around an index, crude oil posted price.

Q. Oh, I see. Does your Honor wish to recess now?

The Court: We will take a recess.

(Recess.)

Q. (Mr. Rosenberg): Mr. Pryor, with refer-

(Testimony of O. Kenneth Pryor.)

ence to by-product accounting, cost accounting, as I understand it it is your opinion that it is improper to include any indirect charges, any overhead or any charges that are not ascertainable with exactitude; is that right? [654]

A. I think my full definition was, any necessary expenses that were directly and solely attributed to the by-product that can be ascertained were proper charges to it.

Q. Would that exclude anything that could not be directly related to anything that had to be allocated on the same basis?

A. Yes, that is correct.

Q. Of course, that is not true of a co-product or joint product, is it?

A. No, that is not true of a co-product or joint product.

Q. And in a co-product or joint product it is common practice to allocate among the various co-products or joint products certain types of expenses which cannot be directly related to the respective products, is that not true?

A. That is common practice. I think I would like to clear up one point which I think I may have been confused on, one of the questions, just before the recess. I wished at that time to make this point, my answer to the question when you compare two accounting periods that were—where the change between the two accounting periods may have an effect upon an outside party will make a difference in my thinking as to overhead. Now, I would like

(Testimony of O. Kenneth Pryor.)

to make this point: If a company allocates overhead to its products it has a certain leeway or choice, you might say, for its own purposes, whereas if an outside party is involved then there is a great responsibility put on them to use proper bases for allocation, and to allocate [655] proper items and to allocate it on a basis which is comparable between periods. In other words, there is a greater responsibility on the company computing cost of manufacture where an outside person is involved than if they were just doing it for their own internal purposes.

Q. That is not a matter of accounting. That is a matter of common business integrity, isn't it?

A. Yes, but I think—I answered the question there once before.

Q. That would apply whether you are talking about a by-product or a joint product or a single product, wouldn't it?

A. I am assuming always here that you are talking about the allocation of overhead for your internal purposes as opposed to where somebody else might be involved.

Q. For instance, you testified in reference to this Exhibit 15, I don't know whether I understood your last statement, but when you came to this matter of fuel it shows 1 cent in the second column and none in the first. You don't know whether that results from a change in accounting or whether it results from a change in circumstances, do you?

A. That is to say whether it was a change in

(Testimony of O. Kenneth Pryor.)

accounting or that fuel was changed to some other fuel?

Q. Yes; you don't know what that was?

A. No, I don't know what the facts are.

Q. In other words, you will concede, will you not, that if a [656] change occurs in one period of necessity by reason of a change in circumstances, a change which did not occur in the prior period, it is nevertheless a proper charge, isn't it?

A. Well, that wouldn't be the only basis as to whether it were a proper charge, but assuming for a moment that whatever we are referring to is a proper charge, then I think you have got to put the two periods in making a comparison on a comparable basis.

Q. Would you say this, Mr. Pryor, and indulging in one of your own presumptions that in the second period we had a cost for fuel and power that did not occur in the previous period, that you would adjust the previous period to make it appear as if the expense had occurred?

A. I cannot conceive of just exactly that situation. Why wouldn't it have occurred in both periods? Perhaps I could answer—

Q. Well, I am asking you to assume there is some valid reason why it occurred in the second period and did not occur in the first period, such being the case, I am asking about the propriety of including it in the second period.

A. If it was a new expense that was directly attributable and had not been incurred before, I don't see anything wrong with doing that.

(Testimony of O. Kenneth Pryor.)

Q. Let's assume that you have an expense that was incurred in the prior period but was put in a different account, and [657] then in the second period it appears for the first time in a new account, I believe you stated it that you would eliminate that from the second period.

A. Not because of the account that it was classified in, but because of the nature of the item.

Q. Well, at any time if you find an expense had occurred for the first time in the second of two comparative periods before you could determine whether or not that should be eliminated from the second period you would have to find out whether a similar expense is in the first period but in a different account?

A. If you had the expense, for example, in a direct charge account in the second period and that was a necessary expense and properly attributed to it, but you had that same expense in some other account in the first period of the two periods, you ought to put the two periods on a comparable basis, either put it in both places or take them out.

Q. Say in the first period you have it in account No. 3 and in the second period you have it in account No. 5, and say in the second period it appears you had that charged in account No. 5, but that you did not charge it in account No. 5 in the preceding period, but it was in account No. 3 in the preceding period, nobody is being done an injustice under those circumstances; isn't that true?

A. I don't know what account No. 3 and No. 5

(Testimony of O. Kenneth Pryor.)

are, but if [658] account No. 3 was a direct charge account and account No. 5 is a direct charge account I don't believe there would be any point to the question.

Q. No, it wouldn't make any difference under those circumstances, would it?

A. It is the nature of the item.

Q. That's right. With reference to cost accounting for by-products is it your expert opinion that the method which you have testified to the court as your opinion of the proper accounting method to be followed is the only proper accounting method for by-product cost?

A. Very frequently companies do not even determine costs of a by-product.

Q. I am talking about where you are determining costs.

A. And you are determining cost of manufacturing?

Q. That's right, cost of production, cost of manufacture.

A. It is the only proper basis of accounting which, I might say, I conceive. It is backed up by common sense, that is to charge the cost to that by-product which you are out of pocket because you produce that by-product.

Q. Wouldn't it be just as logical—what is the philosophy in back of that reasoning? Wouldn't it be just as logical to say in case of a plant that is making 10 joint products that if you are going to discontinue one product and if in that event there

(Testimony of O. Kenneth Pryor.)

were certain expenses that would continue [659] notwithstanding the discontinuance, but in a lesser and unascertainable amount, that, therefore, you may include in the cost of producing that product any of these overhead or indirect charges?

A. That is not quite the philosophy. The philosophy of joint product accounting is that you are in business for the purpose of making all your joint products and they should, of course, stand a reasonable proportion between the products as to the cost of manufacturing.

Q. Then consistent with that would you say in the presumption you must apply that if Westvaco is in the business of making bromines and gypsum, no magnesium, you would have to include all of your proper production costs in determining the cost of production of each of these products?

A. When you use the word "proper," I don't know exactly what you mean.

Q. I mean the same items of cost of production that are proper for the inclusion of a manufactured product.

A. Direct charges to any particular product, that may be so, but when it comes to overhead I think it is something different.

Q. Well, overhead is proper to include in the cost of production of a main or co-product, isn't it?

A. It depends on what you mean by overhead again.

Q. I am using it in the sense you used it.

A. In all of them, as I understand the type of

(Testimony of O. Kenneth Pryor.)

overhead we [660] are talking about here, which is on one of the exhibits—I have forgotten the number——

Q. No. I am talking about overhead in the sense you used it. I don't like to have to go over it again. I understood you to say that overhead in the sense that you used the term is a proper element in the cost of production of a primary, main or a joint or co-product.

A. I meant to say, if I said that, manufacturing overhead.

Q. That is just what I mean, too. I understood you to say just a moment ago that if that plant is set up for the purpose of producing a number of products, then you would distribute those charges, including overhead, against the products that are produced; didn't you say that?

A. The primary product, but not the by-product.

Q. Well, if a plant is put up for the purpose of producing several different products, would you consider any one of them a by-product?

A. Very possibly.

Q. How do you determine whether it is or it is not?

A. A by-product is a product that is produced incidental to the main manufacturing process which was not the primary purpose of the plant to produce, the by-product. It was the primary purpose of constructing the plant to produce all products exclusive of the by-products, because that product would not be a consideration alone. Any company,

(Testimony of O. Kenneth Pryor.)

in starting to go into [661] business figures all sources of its income, everything it can conceive that might have a bearing on whether it will build the plant, or not, but that depends always on the products.

Q. Well, what is your basis, again, when a thing is a by-product, or joint product, or co-product?

A. I think the definition which is most generally used of a by-product is a product which is produced as an incidental to the production of a main or principal product, primary product. That definition, I think, has already been testified here before, and I think I can subscribe to it, that there are two types of by-products, the type that you can sell the minute it is separated from the main process, and if you have to do something to it before you can sell it.

Q. In other words, I understood you to state that if something comes off of the production line incidental to the production of another product, that it is ipso facto a by-product; is that true?

A. I do not believe I know exactly what you mean, because if the production line, if it is merely produced as an incidental to the production source it goes on whether you want to produce it, but if it comes off automatically, you can't help hardly to produce it, then I think it is a by-product.

Q. Even though perhaps it was one of the motivating considerations that caused you to produce the plant, to construct the plant, you would nevertheless consider it a by-product, would you? [662]

(Testimony of O. Kenneth Pryor.)

A. As I said, when you consider whether or not you want to construct the plant you take in what you think you can get for all your products, by-products and joint products, and perhaps for even outside engineering services you might perform for somebody, you take all the income into consideration and you add up all your expenses, and if you think you can make an over-all profit you build the plant.

Q. And you would consider after you had built your plant then you as an expert, certified public accountant, if you were called in to set up the books for that company you would say, "Now, anything that comes off incidental to the production of another product in this plant is a by-product and therefore we will keep our cost records only in so far as direct labor charges and direct charges directly attributable to that product, would you?"

A. That would be good accounting and accepted accounting to generally follow.

Q. In other words, you would do that as an expert if you were called in to a plant that was constructed to turn out a number of products, and if you went into the plant and you found out that one product, regardless of how important it was to the manufacture came off the production line incidental to the production of another product, then you would employ the by-product accounting practice to which you have testified, and would not treat it as a primary or a joint product? [663]

A. I think when a company builds a plant it usually understands, or it understands the process

(Testimony of O. Kenneth Pryor.)

that it is going to use for the product right from the very beginning, and I think it would be proper accounting to treat it as such.

Q. I see. Let me ask you this, Mr. Pryor, with reference to this shipping expense. I will ask you to assume that over at this Westvaco plant at Newark, California, we have a shipping department, and out of this department we ship magnesia products, we ship from the shipping department, and as far as the direct labor, here we have two products, and I will refer to them and say we keep time cards for that direct labor. Assume for the proper conduct of that shipping department we have to have a superintendent and we have to have a foreman, we have to have a foreman assistant, and those men devote their time to that shipping department, to the shipping of those two products, gypsum and magnesium. Now, I want you to tell me as an expert public accountant whether it is your contention that the magnesia should bear all of the cost of this shipping department, the foreman, the foreman assistant, the shipping clerk, and include in that hypothesis the assumption that the volume of gypsum shipped, the quantity and tonnage of it exceeds the magnesia. Now, tell me that.

A. If those people who cannot be assigned directly as spending all their time on gypsum are working in that plant, and would continue to go on whether or not you produced gypsum, then I [664] think they should be charged to the primary product, magnesia.

(Testimony of O. Kenneth Pryor.)

Q. Let's assume that we discontinued magnesia and their services would be necessarily continued purely for the purpose of handling gypsum.

A. And that is all the plant made?

Q. Let's assume it.

A. Then it would be the primary product.

Q. What is the logic, the magic attached to the word "by-product" that where men are actually devoting services to the handling of a product and merely because you attach a label to it, that you should not charge it with expenses that would be properly chargeable to it if you attached a label main product to it. Will you explain the logic of that?

Mr. Bennett: I think that is argumentative, your Honor. The witness has answered it. If there is any further answer to be given——

The Court: You may answer.

A. I think the logic goes back again to my illustration of how a man determines whether or not he is going to process and sell a by-product. If it costs him out of pocket 9 cents to process it, and he can sell it when finished for ten cents, then it is good business to do so, but if by allocating indirect expenses, which would go on anyhow whether or not he was producing that product, and other expenses of an overhead nature which would go on anyhow whether he produced the [665] product, he would have had 2 cents of indirect expense, making a total cost of 11 cents, then he would not produce the product, so it is just common sense that you

(Testimony of O. Kenneth Pryor.)

only charge in making up your mind whether to produce or not the amount you are out of pocket for it. [665-a]

Q. (Mr. Rosenberg): It is only common sense you start with the assumption that there is some reason for employing a different method in accounting for by-products and joint products?

A. You start with the assumption that it is a by-product.

Q. Let me ask you this: Let us assume in that case that you know that if you discontinue gypsum your miscellaneous shipping expenses of the nature that I have mentioned will be reduced but you can not tell exactly in what amount. Then you would likewise under those circumstances say that, notwithstanding that you know that gypsum is getting the benefit of the services, that those employees are necessary in order to get the gypsum out of the plant and to ship it to the buyer, nevertheless gypsum should be charged with no part of that cost, is that your expert opinion?

A. If one of those shipping clerks could be dispensed with, if you discontinued, then I think that clerk is not an indirect expense but a direct expense and his salary ought to be put in there in the first place.

Q. How can you tell it is a direct expense? He is working on both gypsum and magnesia.

Mr. Bennett: I think it is further argumentative, counsel. The witness has stated if the discontinuance of gypsum would eliminate one of the men,

(Testimony of O. Kenneth Pryor.)

that means that that man was working presently on gypsum and his salary or wages, social security and other taxes should be charged against gypsum.

Mr. Rosenberg: I have withdrawn the question, Mr. Bennett.

Q. If instead, then, of having handled the shipping of gypsum and magnesium out of one shipping department, Westvaco should set up separate shipping departments and have a superintendent in the magnesia department and one in the gypsum and a foreman in each department, then would you say that that category of charges in the gypsum shipping department would be proper expenses to include in the cost of producing gypsum?

A. If they meet my test, if necessary, then I would say they are because they are devoting their full time to it.

Q. You apply the same theory and reasoning to all of these other indirect charges that you mentioned, is that true? In other words, let us take the laboratories at the plant. Under our contract we have to bring that gypsum up to certain specifications and therefore it is necessary for us to sample and test and analyze the gypsum, and those services are done in a laboratory in which other products in the plant are likewise tested and analyzed because it is economical to have only one laboratory instead of three or four. Now, is it your expert opinion that although that service is absolutely necessary in order to produce and deliver the gypsum pursuant to this contract, that it is an improper charge to

(Testimony of O. Kenneth Pryor.)

gypsum merely by virtue of the fact that you have to allocate it in the same manner that you would allocate it if it were considered a joint product? [667]

A. My answer to that would be presuming always that this is a laboratory man who is engaged in controlling, we will say, the production within the gypsum plant and he devoted all his time to that plant, he would be out there as direct——

Q. No, that is not my question at all. Let us say you have got a laboratory. A. Yes.

Q. And let us say we have two expert chemical technicians in there and we have to test our magnesia products and we have to test our gypsum products, and when we are making bromine we have to test our bromine products, and it would be uneconomical to have a separate laboratory for each product, but it is indispensable to the proper production and delivery of gypsum under this contract that we have a laboratory in which to perform these services. Do I understand that you as an expert dispute the propriety of allocating some fair production of that charge to gypsum?

A. If you could not dispense with the services of one of those two technicians by the discontinuance of production of a by-product, then I do not think the by-product should stand any part of the expense.

Q. But if we set up a separate laboratory and it would require the services of one technician to

(Testimony of O. Kenneth Pryor.)

do this work for gypsum, you would not question that, even though it is a by-product?

A. If that is a necessary expense, I think it is a direct one. [668]

Q. The sole basis of your objection is it has to be allocated and can not be determined directly, is that it?

A. I would not say that that is the sole basis.

Q. You admit that the service is a proper service to include in the cost of production if it could be determined on a direct basis, but you dispute the propriety of including any cost for the service if you have to allocate it, isn't that true?

A. I think the heart of the thing is, Are you out of pocket any or would you be out of pocket any—let me start that answer over again. The question is, Are you out of pocket any?

Q. That is not my question, no. I am asking how and on what logical basis you as an expert accountant hold the opinion that under the circumstances that I mentioned it would be improper to charge anything to gypsum because of the fact that you would have to allocate it on some rational basis.

A. To begin with, I do not think allocations are proper, and the other answer is, the other reason is, that you would not cut your expenses down any by discontinuing the production of gypsum. Therefore I think the entire expense should be charged to the principal product and not gypsum.

Q. And if we had a laboratory where we were

(Testimony of O. Kenneth Pryor.)

testing ten different products, if we discontinued any one of them, the expense of the laboratory would continue anyway, wouldn't it?

A. Are you talking about joint products now?

Q. Joint products, yes. [669]

A. As far as I know, I guess so.

Q. Do I understand you to say as a general proposition, as an expert accountant, you do not favor allocations?

A. No, I did not say that.

Q. I must have misunderstood you. I do not know whether I asked you this. If so, I would like to ask it again: Isn't it true that it is not uncommon in instances where, by reason of a contract or other business considerations, it is determined necessary to keep records and compute costs of production of a by-product, that it is not uncommon, even though you may not agree with it, to include the same elements of cost as you do in the case of a joint product or a co-product?

A. Are you speaking of direct costs only now or all costs?

Q. No, everything you would include in the case of a joint product.

A. I do not think it is common.

Q. Do you not think it is. And I believe you said before these opinions that you hold are purely your own personal opinions based upon your own experience, is that true, and what studying you have done from undisclosed sources, is that right?

A. That is all my opinion can be based on.

(Testimony of O. Kenneth Pryor.)

Q. With reference to overhead again—I do not know whether I understood your testimony or not, but I want to get it clear: Assuming that overhead would be a proper item in the cost of production of gypsum, then there is no doubt that in making [670] comparisons between one period and another you would include overhead in both periods, wouldn't you?

A. Manufacturing overhead, yes.

Q. With reference to this Exhibit 15, when you were asked about supervision, which appears to be allocated, and you said you do not agree with the allocation, you said you did not believe there should be any arbitrary allocation of supervision, what did you mean by that?

A. To by-product gypsum?

Q. Yes.

A. I do not believe that supervision should be charged to by-product gypsum.

Q. What did you mean by arbitrary, or didn't you attach my significance to the use of that term, or were you just saying what you have said with reference to everything else, that if you have a plant superintendent, a general management and everything that has to do with the operation of the gypsum operation, as well as the other processes in the plant, that it is your opinion that unless they can be directly related and determined without allocating, you do not believe they are proper to include in cost of production, were you referring to the same principle when you mentioned supervision?

(Testimony of O. Kenneth Pryor.)

A. That we just referred to with regard to laboratory, for example, yes.

Q. You are just following out, being consistent in that [671] opinion, is that right?

A. That is right. I think that I said that I do not think arbitrary allocations where another party is concerned are proper either.

Q. Also—I will be through in a couple of minutes, I hope—Your Honor—with reference to this supervision, you have mentioned the footnote 5 and directed attention to the fact that there was a different percentage allocated in one period than in the other period.

A. Yes.

Q. And you said that that indicated to you that there was a change in accounting, is that right, in accounting method?

A. I do not believe I said that.

Q. What did it indicate to you? What was your objection to that?

A. I do not know that I took exception to it because I was eliminating the entire item. I do not know how those percentages were determined.

Q. If it were proper to allocate supervision, and if by reason of some change in circumstances and consistent with the same basis of allocation, it resulted in a different percentage in one period than in another, you would have no objection to that if you were in favor in the first instance of allocating it, would you?

A. You say in the same circumstances? [672]

(Testimony of O. Kenneth Pryor.)

Q. No, I say by reason of change of circumstances.

A. Well, changes in circumstances might and, assuming it is proper to allocate items, changes in circumstances might lead me to adopt an entirely different basis of allocation.

Q. When would you do that?

A. For example, supposing you were taking over the labor and using that as a basis, and in the first of the two periods you had a process you were going through with very little direct labor and in the second period you had a process where you had a lot of labor in your primary product or your secondary product or any other product, it might be some other basis besides a direct labor basis would be appropriate.

Q. For the second period?

A. For the second period, but I would like to make this clear, that you have got to be consistent as between the two periods. Now, if you use a basis in one period, you should use the basis in the other period.

Q. So if you are going to be consistent, if you are using direct labor in the first period, you would have to use direct labor in the second period regardless of what result occurred, wouldn't you?

A. I do not believe I understand that exactly.

Q. Well, I do not think you do either, Mr. Pryor. As I understood you a moment ago, you said that if you used direct labor in the first period, then in the second period, through change [673]

(Testimony of O. Kenneth Pryor.)

of circumstances, there was either a great deal more or a great deal less, you might use a different basis of allocation, and I had understood you to say that one thing you insist upon is consistency.

A. The application of consistent accounting principles.

Mr. Bennett: I do not think that that is his testimony, Your Honor. I think what the witness said he did not understand was counsel's question, not that he did not understand the subject matter.

Q. (Mr. Rosenberg): What is your testimony now under the circumstances you just suggested yourself, where you use direct labor in one period and then by reason of change in circumstances you in your good judgment feel that some other basis of allocation should be used in the second period? Would you use it or wouldn't you use it?

A. And there is a change in circumstances?

Q. Yes. A. Then I might change my basis.

Q. Then you might change?

A. Why, yes.

Q. I am sure you would. Also with reference to this business here on the blackboard, you have stated that in your opinion there should be no bit-tern charged to gypsum, is that right-

A. As I understand it, that is the——

Q. That is your sea water? [674]

A. That is the sea water; then I do not believe that any part of that should be charged to the cost of producing the by-product gypsum.

Q. That again is premised entirely upon your

(Testimony of O. Kenneth Pryor.)

conception of gypsum, that is, upon your assumption of gypsum as a by-product, is that right?

A. That is right. If it were a joint product it might be something else.

Q. (The Court): How can you produce gypsum unless you have the bittern?

A. That, of course, I do not know the chemical processes here.

Q. I do not either, but as a practical matter——

Mr. Bennett: I can give Your Honor this example: How can you produce sawdust without logs?

The Court: How can you what?

Mr. Bennett: How can you produce sawdust without a log in a lumbering operation? Lumber is the primary product.

The Court: Eliminating that, I had in mind the method you were attributing costs here. It might be interesting to you to know that I worked in the largest sawmill in America about 40 years ago.

Mr. Bennett: I know, and I know Your Honor has had other experience, too.

The Court: I never got far from the business operations. The central question here I asked, and I have my own reasons for [675] asking, we begin with bittern here.

Mr. Bennett: Yes, Your Honor.

The Court: You could not produce gypsum if you did not have the bittern.

Mr. Bennett: You could mine it out of the hills. You mean in this particular operation?

(Testimony of O. Kenneth Pryor.)

The Court: This operation.

Mr. Bennett: That is true, Your Honor, just as you have to have a peach to produce a peach pit. But the point the witness has made, and all our witnesses so far, and the position that we take is that where the gypsum is not the primary product——

The Court: I understand.

Mr. Bennett: And whereas in this case, when we did not meet their demands, they actually stopped producing gypsum, they went ahead and used the same quantity of bittern to manufacture the end product, in such a situation it is improper, both from the standpoint of accounting and the standpoint of common reasoning to assess as against the by-product the raw material which is necessary for the production of the main product, whether or not the by-product is produced. In this case, if it please the Court,——

The Court: You start with a by-product. The bittern itself is a by-product.

Mr. Bennett: Of course it may be a by-product so far as the [676] Leslie Salt Company is concerned, but it is not a by-product is so far as the manufacture of Westvaco is concerned. It is its main product, just as seeds from a cotton gin may be the by-product from the gin, so far as the gin operator is concerned, but it is not a by-product when it comes into the plant, say, of an oil refining corporation. In that situation the cottonseed is the main raw material and out of the main raw material

(Testimony of O. Kenneth Pryor.)

they make oil, which is the primary product, and the shells from the seed are oftentimes made into cattle feed, which is a by-product.

The Court: I understand. Is that all from this witness?

Mr. Rosenberg: I have one more question.

Q. Directing your attention again to this Exhibit 15, your attention was directed to sulphuric acid, and you stated that from the fact that there is a charge in the second period and none in the first period—did I understand you correctly to state that that would indicate to you that there had been a change in accounting practice?

A. Yes, it does indicate that.

Q. It does? Can't you conceive that there might have been some other circumstances that contributed to that?

A. Yes, perhaps sulphuric acid was not used at all in the first period and was used in the second period in the operation all the way from the beginning of the plant to the point where magnesium oxide is delivered. [677]

Q. It might result from a change of circumstances rather than a change of accounting practice, isn't that true? A. Why, certainly.

Q. You do not want the Court to understand that it is your expert opinion that that indicates a change in accounting practice, do you?

A. Oh, no, I do not know the circumstances of why the item is put in on a sheet.

Mr. Rosenberg: That is all.

(Testimony of O. Kenneth Pryor.)

Mr. Bennett: I could probably finish with the witness unless Your Honor plans an adjournment at this moment.

The Court: It depends on you. How much time do you wish? I do not want to hurry you but the Judges have a meeting at 4:00 o'clock.

Mr. Bennett: The witness can come back in the morning and we can finish in a few minutes then.

The Court. All right.

(Thereupon a recess was taken until tomorrow, Friday, December 19, 1947, at 10:00 a.m.)

Friday, December 19, 1947, 10:00 o'clock a.m.

O. KENNETH PRYOR,
resumed the stand;

Redirect Examination

Q. (Mr. Bennett): Mr. Pryor, during your cross-examination you referred to a client of your firm, a chemical industry engaged in the production at one of its plants of ammonia, and incidental to that operation there was produced a product, as you described it, of carbon.

A. That is the basic raw material from which the by-product is produced, carbon, and it is processed from that point on.

Q. The main or primary product produced at that plant was ammonia?

A. That was the end product, yes.

Q. And the carbon was produced as an incident to that manufacture by the heating of the natural

(Testimony of O. Kenneth Pryor.)

gas from which the end or primary product was made?

A. It was separated from the hydrogen which was contained in the natural gas. In other words, there was a point of separation of that carbon in the process.

Q. The removal of that carbon being necessary to manufacture from the raw material, natural gas, the primary product, ammonia, is that correct?

A. That is correct.

Q. And then this residue carbon was further processed and made [679] into some other product, was it?

A. Yes. It was used primarily, I believe, in the production of what they call briquets, which were used for fuel.

Q. What was the treatment so far as accounting costs of production of the briquets that were made from the carbon?

A. They only charged to cost of production of the briquets those direct expenses which they were out of pocket in processing the raw carbon.

Q. State whether or not there was considered as part of the cost of producing those briquets any allocation of indirect or overhead, or so-called overhead?

A. No, there was not.

Q. Was any part of the raw material, the natural gas, charged to the production of this carbon?

A. No, there was not.

Q. That method of accounting and the determination of the cost of production of the by-product

(Testimony of O. Kenneth Pryor.)

briquets was in accordance with the opinions that you have given here as proper determination of cost to be included in the cost of production and the cost of manufacture of gypsum?

A. That is correct.

Q. During the trial, both on your cross-examination and the cross-examination of other witnesses, reference has been made by counsel to a booklet or publication containing several parts, pamphlets, bound under the title "National Association of [680] Cost Accounting," Volume 1, December, 1919, to December, 1920, and you testified you had not seen or read that volume.

A. That is correct.

Q. After it was first referred to in the courtroom did you make any effort to find or locate it?

Mr. Rosenberg: I object on the ground it has been asked and answered. I asked him and he said no, he did not consider it was necessary.

The Court: He may answer in the interest of time.

A. I personally made no search for it. I know a search was made.

Q. (Mr. Bennett): Do you have this volume in your library or office? A. No, I do not.

Q. Do you know that to be a fact?

A. I know that to be a fact.

Q. State whether you agree with this statement, Mr. Pryor—and I am now reading from page 14, Volume 1, No. 7, dated August 20th, entitled, "Accounting for By-Products," in this particular volume:

(Testimony of O. Kenneth Pryor.)

“If the by-product is of so little value at the time it arises that it normally would be dumped, it often is manufactured and sold practically without profit in order to eliminate the cost of dumping. In that case only the cost of getting the by-product into salable state should be charged to it.” [681]

Mr. Rosenberg: May I see what you are reading from, Mr. Bennett?

The Witness: That is theory of by-product accounting which I have been describing. That is my understanding of what good by-product accounting was.

Mr. Rosenberg: Let the record show that counsel is reading from this official publication of the National Association of Cost Accountants, Volume 1, No. 7, dated August, 1920, and entitled, “Accounting for By-Products.”

Mr. Bennett: That was stated, counsel, and apparently it appears in the form of a pamphlet together with other pamphlets which have been bound together in this so-called 1920 volume. That is the same book that you were referring to and reading from when you examined the other witnesses and referred to in your cross-examination of this witness, isn't it?

Mr. Rosenberg: That is right.

Q. (Mr. Bennett): Mr. Pryor, you stated to the court your opinion as to the rule that should be applied in determining cost in a situation involving the manufacture of a by-product, where not only the manufacturer, for his own purposes is con-

(Testimony of O. Kenneth Pryor.)

cerned, but also where there is concerned the interest of the purchaser in the matter of any actual advance in cost of manufactured of the by-product between two twelve-month periods. Will you state to the court the reasons in your opinion for the application of such rule? [682]

Mr. Rosenberg: I submit that is not proper re-direct examination. My recollection is the witness was asked precisely the same question on direct examination.

Mr. Bennett: I asked him, your Honor, and he has given your Honor the rule; on cross-examination he was cross-examined at length——

The Court: In the interest of time I will allow it so we may get through.

A. In the first place, I think the logic back of my theory of determining the cost of manufacture of a by-product is based on common business sense. It is logical. It makes sense that you only charge to it those out-of-pocket expenses that you have, and you do not try to allocate to it expenses that would go on anyhow, whether or not you produced or went ahead and processed your by-product. For that reason I think the rule is a common sense rule as well as good accounting. But in the situation you described, I think you have got further reasons for not making allocations to the by-product cost. In the first place, if you make an allocation to a by-product you will have to adopt certain presumptions and hypotheses and assumptions, and they do not come up with something that is actual when you

(Testimony of O. Kenneth Pryor.)

do that. I might illustrate what I mean there by putting it this way:

Suppose we use direct labor as a basis of allocating some indirect or overhead item, and let us assume that the ratio of [683] the direct labor in the manufacture of the primary product remains constant as related to the by-product in the two years, the first and second years which is affecting your computation. But assume that you increased your overhead in the engineering department, we will say, by putting on a new man, a new engineer, who was perhaps working on designs or working on processes, even after the point of separation of the by-product, but at least not working on gypsum, and you needed that new engineer for your other or primary product. You would get an artificial increase in your per ton cost of production of the by-product there because of this allocation basis, where actually there was no increase in the cost of production of the by-product. It is bookkeeping, or it is a theory and not actual.

I think there is the further reason also that could be demonstrated, and that is when you get away from the plant operations of the by-product and you go to a more remote point and you have various and sundry kinds of overhead, new product research, accounting, donations, mine explorations, and such things as I have seen on this list of so-called overhead, and you use a direct labor basis for allocation, or, for that matter, any basis of allocation that I could think of, if you tried to apply the

(Testimony of O. Kenneth Pryor.)

same basis of allocation to every one of these items, the total, you are bound to have an artificial figure. It is based upon assumptions. You make an assumption when you distribute New York overhead to West Coast. You make [684] some further assumptions when you consider transferring the West Coast expense to the plant, and you make further assumptions when you allocate the overhead within the plant to a principal product and a by-product, and I think it becomes so remote and so hypothetical that I do not believe there is good justification for saying in any way that it is actual, that it represents an actual increase, and I think those are the principal reasons I have in mind.

Q. Can you determine, according to accounting methods, the actual increase in the cost of manufacture—and I repeat again the word “actual”—where it involves of allocating, say, indirect and overhead items by any such basis as the relation of labor charges, direct labor charges of the primary product as compared to the by-product?

A. When you adopt an assumption you immediately leave actualities, and I do not think that it does represent actual.

Q. Mr. Pryor, if the problem was to compare two periods, and if in the second period a changed accounting method is adopted due to changed circumstances, let us say, would or would not any re-computation of costs for the first period be necessary in order to make the apportionment a true one aside from any other circumstances involved?

(Testimony of O. Kenneth Pryor.)

A. I think when you change the basis of allocation between periods you more or less have changed the rules of the game in the middle of the game.

When, for example, as I think has been done in this instance, you change the method of allocating an indirect expense from a value basis to a tonnage basis between years, I think you have changed the rules of the game, and I think you either have to play the game under the rules of the first half or the second half, and you should in that case either have them on a tonnage basis both times or a value basis both times, whichever is appropriate, but you should not change.

Mr. Bennett: That is all. Thank you, Mr. Pryor.

Recross-Examination

Q. (Mr. Rosenberg): Mr. Pryor, I just want this record to be straight: By your answer to the last question you did not mean to conflict with your testimony of yesterday, where you conceded that if a new or different charge results in one period due to a change of circumstances, that did not occur in a prior period, you would not dispute the propriety of including the charge, nevertheless, would you?

A. I believe we were talking about fuel oil at that time, were we not?

Q. As an illustration, yes.

A. As an illustration, fuel oil, and I believe the assumption was that we substituted fuel oil for some other fuel for some necessary purpose. Perhaps we could not get natural gas and we had to

(Testimony of O. Kenneth Pryor.)

use fuel oil. Then I think, of course, you have a situation in which you are entitled to make a change between [686] periods, because you have used something in place of something else.

Q. That is right. Let me ask you this: Where you are making a half dozen co-products in a plant, in determining the cost of each of the co-products you would charge to each of the co-products the direct charges, would you? A. Yes.

Q. And then as to the plant overhead and miscellaneous or indirect plant charges, you would allocate those between the six products, would you?

A. Those are the manufacturing costs, yes.

Q. You would use as a basis for allocation such allocation factor as you in your good judgment considered most likely to arrive at an equitable result approaching the actual, would you?

A. Well, I might use many factors, applying a different factor to different types of manufacturing costs, of course. I do not want the record to appear that I meant you would have one factor and apply it to all kinds of expenses regardless of their nature.

Q. No, but you would have to allocate on some rational basis, and the reason you would have to allocate is because you cannot determine the actual, isn't it?

A. That is true with regard to such things, as, we will say, plant watchman.

Q. And plant superintendent? [687]

A. Yes.

(Testimony of O. Kenneth Pryor.)

Q. And bookkeeping and accounting?

A. Just a moment. The bookkeeping and accounting, as regards the cost of accounting for production within the plant, that would be true.

Q. That is what I have been talking about.

A. I do not mean sales accounting, in other words. I just wanted to make it clear.

Q. But you have to allocate those because you can't determine the actual?

A. That is the practical way most people follow who have nobody else to worry about but keeping their own books.

Q. Yes, and if you have somebody else to worry about you would still have to use the same book-keeping method. You would have to allocate on some basis, wouldn't you?

A. Yes, but I think your responsibilities for allocating to a particular product, when you are involved in only one particular product, would become a great deal greater.

Q. I won't argue with you on that, although it has nothing to do with what I have asked you. I will ask you this simple question, and eliminating now the question of by-product. A. Yes.

Q. To determine the cost of production of a co-product you have to allocate certain charges because you cannot determine them actually, is that true? [688]

A. That is generally speaking done.

Q. And that is no objection to the accounting, is it? A. No, it is not.

(Testimony of O. Kenneth Pryor.)

Q. And so if I understand your reasoning, your reasoning is that it is improper in the case of a by-product because, according to your expert opinion, you should not charge anything to a by-product that cannot be determined with exactitude, is that right?

A. I think that is true, but when I was talking about the further reason here I was making an assumption that you make an allocation to a by-product, and the further reasons were based upon the question as put to me, that there was somebody else involved.

Q. And you said the reason you did not think it was proper is that in order to make allocations you have to indulge in assumptions which are assumptions rather than actualities, isn't that what you said?

A. That is because the word "actual" was put to me.

Q. You have to indulge in the same assumption when you are making allocations in the case of co-products, don't you?

A. That is what you generally do.

Q. But that is no objection to doing it. You have to do it as a matter of expediency because there is no better way to do it, is that right?

A. For that purpose I have no objection at all.

Q. Let us take the case of this carbon deal you were talking [689] about. In that case, as I understood your testimony yesterday, there was a contract to sell that carbon, but the cost or the price

(Testimony of O. Kenneth Pryor.)

to be received for the product was not dependent upon the cost of production, was it?

A. No, there was no contract to sell that carbon. I do not believe I testified to that.

Q. Isn't this true, Mr. Pryor, that accountants follow the practice of keeping accounting records in the most practical form and in the simplest form that is expedient for the purpose of the particular client that you are serving?

A. That is correct.

Q. Sure, so that where you have an operation of that kind it did not make a particle of difference to the firm that was producing this carbon whether they kept any cost records of this carbon, did it?

A. I would say no, although I do not want to quibble with you about the thing.

Q. Don't hesitate to quibble with me.

A. I can conceive of a situation where it might make a difference to them. In other words, they have to determine whether to make it or stop making it.

Q. Having determined to make it, they could have elected not to keep any cost records?

A. That is right.

Q. And it would not have made a particle of difference to the [690] buyer or seller?

A. No.

Q. So the fact is whether another person is interested should control your accounting depends on from whose viewpoint you are looking at it, whether it is the buyer's or the seller's viewpoint?

(Testimony of O. Kenneth Pryor.)

A. In that particular case there was nobody involved and they did it the way I think it should be done where somebody is involved.

Q. You do not think it makes any difference whether somebody else is involved?

A. No, I do not think it makes any difference so far as my general principle is concerned, but I think I have pointed out if you are going to make allocations, if there is some basis, which I do not believe is proper, but if you are going to, they are compelling reasons beyond the others.

Q. Let me ask you on this carbon deal, how did they treat the proceeds of the sale?

A. I do not recall whether they credited them to the cost of the principal product or took them into sales.

Q. You do not know?

A. I don't remember, no.

Q. Did you set up that accounting system?

A. No, I merely approved it.

Q. But it is possible they were following the simple expedient [691] of treating the recoveries from the sale of the by-product as a cost in the production of the main product, is that true?

A. I don't know.

Q. You say you don't know. Perhaps they did that?

A. What I meant by that was I do not know how they were treating the proceeds from the briquets. I know how they determined their cost of production.

(Testimony of O. Kenneth Pryor.)

Q. But it is possible that they treat the proceeds from the sale of the briquets as a reduction in the cost of production of the main product?

A. I think if they treated it on that basis, what they would do would be to take the sales of the briquets, match against them the cost assigned to the briquets, and credit the net to the principal product.

Q. But the fact of the matter is you do not know just what they did in that respect, do you?

A. I am not sure. I did not look it up, no.

Mr. Bennett: You are talking about what happens to the money received from the sale of it?

Mr. Rosenberg: That is right. That is a matter of accounting in a firm where it does not make any difference how they keep their account records.

Q. Let me ask you this: In that operation was the amount of carbon produced dependent upon the amount of the end product produced? [692]

A. The amount of carbon produced is dependent on the amount of hydrogen produced, and I presume, therefore, you might say in effect that is what the effect is.

Q. What do you mean "in effect"? That is actual, isn't it?

A. They may go out and buy their hydrogen, you see.

Q. Then they would not be making it. I am talking about what they did in this plant. Is it true the amount of carbon they produced was de-

(Testimony of O. Kenneth Pryor.)

pendent directly upon the amount of hydrogen that was produced? A. I would say so.

Q. Getting back to this official publication of the National Association of Cost Accountant, have you read this? A. No, I haven't got it.

Q. Counsel picked out a little paragraph here. You scanned this yesterday, didn't you?

A. I do not know what you mean by "scanned it."

Q. I gave it to you.

A. You gave it to me and I handed it to Mr. Bennett, I think.

Q. You got nothing out of it? I know you sat here looking at it for a few moments. Did you get anything out of it? Did you glean from it that the article states there are three methods of by-product accounting?

A. I can truthfully say I did not see that.

Q. You did not. Well, let me ask you if you would agree with this statement—and I might say for the record, your Honor, [693] what the witness was referring to should be read in its context, that the article does discuss three different methods of by-product accounting, and the little excerpt Mr. Bennett read to the witness is under the heading, "Advantages and disadvantages of the second method, and refers exclusively to the discussion of the advantages and disadvantages of the second method.

Will you agree with this statement:

"In many plants the tendency is to charge as little cost as possible to the by-product on the theory

(Testimony of O. Kenneth Pryor.)

that it is entitled to the free use of the shop's equipment. Nothing could be more fallacious. No portion of a factory's output should be favored over any other. The output should be charged with its legitimate cost. This can be done correctly only under—"

I will stop it at that point. Do you agree with that statement?

A. May I read that again? I have difficulty following.

The Court: We will take a recess in this matter. I have some other matters.

Mr. Rosenberg: I will leave that book with the witness during the recess.

(Recess.) [694]

Q. (Mr. Rosenberg): Mr. Pryor, I read a statement to you and asked you if you would read it. I don't recall whether you answered it or not.

A. No, I did not answer it.

Q. Do you recall what the statement was?

A. I would like to have the book in my hand because the statement covers several sentences.

Mr. Bennett: So the record will be straight, Mr. Rosenberg, you are now directing the witness to a statement under the heading "Advantages and Disadvantages of the Third Method."

Mr. Rosenberg: That's right.

Mr. Bennett: The statement I read had to do with the "Advantages and Disadvantages of the Second Method."

Mr. Rosenberg: Yes.

Mr. Bennett: There are three methods, as I un-

(Testimony of O. Kenneth Pryor.)

derstand, suggested by whoever wrote that book.

The Witness: Well, in the first sentence, if I may read it.

The Court: You may.

The Witness: "In many plants the tendency is to charge as little as possible to the by-product on the theory that it is entitled to the free use of the shop's equipment."

I do not know, of course, what thought the author had in mind when he said, "as little cost as possible." I suppose you could say a dollar is as little cost as possible. When he [695] uses "free use of the shop's equipment," perhaps he is talking about repairs there which, for example, if it were direct repairs, I would include. I disagree with the theory that you can charge as little as possible; I don't think that is very scientific.

Q. (Mr. Rosenberg): Go ahead.

The Witness: "Nothing could be more fallacious." Well, I agree with that. "No portion of a factory's output should be favored over any other." Well, I think perhaps that is true. I don't know what he means by "favored." I guess you read the next sentence, too. "Each output should be charged with its legitimate cost." I agree with that. I think my definition of what legitimate cost is—I don't know what his definition might be.

Q. As counsel pointed out to you, the author was talking about the "advantages and disadvantages of a third method" and the third method is described as follows: "Under the third method by-

(Testimony of O. Kenneth Pryor.)

products generally are charged with (1) material at an arbitrary value, if necessary; (2) labor expended on by-product after it is separated from the main product; (3) an equitable proportion of overhead; (4) a proper share of selling and administrative expense when these items are applied on the various products or class of products on the basis of manufacturing cost." [696]

Now, having in mind that that is the method that was referred to——

Mr. Bennett: Is that the third method?

Mr. Rosenberg: Yes.

Mr. Bennett: That is the third method.

Mr. Rosenberg: And under the same subject heading, "Advantages and Disadvantages of the Third Method," I will ask you if you agree with the statement, "It should be remembered that the manufacturer of by-products usually expects to receive for them a price which will cover the cost of labor and overhead and allow a reasonable profit." Would you agree with that?

A. That he——

Mr. Bennett: Labor and overhead.

The Witness: Overhead.

Mr. Rosenberg: It should be remembered that the manufacturer of by-products usually expects to receive for them a price which will cover the cost of labor and overhead and allow a reasonable profit."

Do you agree with that?

A. I don't think that that would be the determining factor in his mind. I think he would meas-

(Testimony of O. Kenneth Pryor.)

ure his out-of-pocket expense against what he could get for it, not all the overhead and everything else.

Q. So you would not agree that a manufacturer of by-products usually expects to receive a price that will cover his labor [697] and overhead and allow him a reasonable profit; you do not think that is true?

Mr. Bennett: That is the vice of using a text like this. He speaks only of labor and overhead and our testimony has shown here we include many others and in addition to labor—it is probable that the author lists under overhead a number of these items that we consider direct charges.

The Court: The witness may answer.

A. I do not agree with that statement. As a matter of fact, in glancing through the article it seemed to me that the author was talking about advantages and disadvantages of three methods and more or less saying that you can do it according to your convenience if it suits your internal purposes. I don't believe doing something for your own convenience should govern if you are trying to compare two periods for the purpose of determining the actual cost of production.

Q. (Mr. Rosenberg): What difference has the comparison of two periods got to do with what is proper accounting; if it is proper accounting you will use it and therefore your two periods will be comparable.

A. Let me repeat, I don't think what might be convenient for a person's internal purpose besides his own to be served.

(Testimony of O. Kenneth Pryor.)

Q. I will ask you where you derive that out of this article, but before I do that I am going to direct your attention to the [698] final sentence in the article and ask if you agree with it: "On the whole, however, the third method is more logical and it gives information which is of vital importance in the administrative control of the business."

Do you agree with that?

A. No, I do not.

Q. Will you show me what portion of what you refer to in stating you think the author said it is a matter of convenience?

Mr. Bennett: Just a moment. May I have the witness' answer to that given back there a little bit?

(Record read.)

Mr. Bennett: I don't think that is the answer I wanted.

Mr. Rosenberg: I asked him, Mr. Bennett, if he agreed with the concluding statement which which states: "On the whole, the third method is more logical and it gives information which is of vital importance in the administrative control of the business."

Mr. Bennett: Did you ask him whether he agreed with that?

Mr. Rosenberg: And I believe he stated that he did not.

Mr. Bennett: He did not agree. Is that correct?

The Witness: Yes.

(Testimony of O. Kenneth Pryor.)

Q. (Mr. Rosenberg): May I ask you, you made a comment earlier that you gathered from the article something about a matter of convenience. I would like you to show me what you were referring to. [699]

A. I don't know that I used the words of that article now. I said I felt that that was the sense of the article which refers to various ways of doing it and gives advantages and disadvantages of those several ways.

Q. Well, then, it is a fact there are various ways that it can be done in accordance with good accounting practice; isn't that what the author states?

Mr. Bennett: You asked him whether the witness considers that or whether the author——

Mr. Rosenberg: No; it is separate and apart from the book.

Q. In other words, there are several different accounting practices that can be employed and are employed in cost accounting of a by-product, but you have given us what, in your opinion, you consider the proper method.

A. That is correct, but I would like to point out again the definition which I was talking about here. You might adopt some method which would be for your own convenience, but it might not be an appropriate one in figuring the cost of production if you had somebody else concerned.

Q. But it is true, is it not, disregarding for the moment the fact that a third person might be affected, you would not say that it is improper ac-

(Testimony of O. Kenneth Pryor.)

counting practice for a manufacturer of a by-product to treat it as a co-product and employ the same accounting methods as he would for the co-product? [700]

A. For his own convenience, he could do it that way, he may do it any number of ways.

Q. Yet you would not say that that was poor accounting, would you?

A. I don't know what you mean "poor accounting," exactly. I think, for example, for a financial statement purpose I wouldn't object probably.

Q. Let us go back to the matter of direct charges. I am going to use the shipping department as an illustration again and ask you to assume this: Assume that this plant over here is making two products, one of the products is gypsum and one of the products is magnesium; you may assume also that the product gypsum is a by-product and assume that the company has a contract to sell all of the magnesia produced in the plant to a third party at a fixed price, we will say, \$46 a ton; the contract provides that in addition to the \$46 a ton, this third party who is the buyer, will pay the cost of shipping the magnesia and placing it on board the cars and you are employed by the buyer and you go into the plant and you see that they have a shipping department which is handling only these two products, magnesia and gypsum, and you find that the quantity of gypsum being shipped is at least as great as the quantity of magnesia, and you find in the shipping department

(Testimony of O. Kenneth Pryor.)

they have a superintendent and a foreman and a shipping clerk, and you find that in keeping their records of costs in the shipping department, they [701] charge all of the superintendent's salary, the foreman's salary, the shipping clerk's salary to the magnesia and nothing of it to the gypsum, and the buyer sent you over there to find out whether or not they were properly determining the amount of shipping expense that he should pay for getting this magnesia out of the plant and to him in accordance with the contract.

Under those circumstances would you go back to your client and tell him that this was perfectly proper, that he was being properly treated in having all of these supervisory expenses charged to him and none to the gypsum, notwithstanding that the quantity of gypsum being shipped out of the plant was at least as great as the quantity of magnesia?

A. On the assumptions that you have made, the gypsum is a by-product and your expenses you just referred to, your supervision would go on whether or not they shipped that gypsum and I don't see what basis I would have for objecting to its inclusion in the cost of the main product, magnesium.

Q. So under those circumstances as an expert certified public accountant and in service to your client, the buyer, you would go back and you would say they have a shipping plant over there and they are handling as much gypsum as magnesia, but they are saddling the magnesia for all of the su-

(Testimony of O. Kenneth Pryor.)

pervisory expenses, but as an expert public accountant I tell you it is all right, go ahead and pay it.

A. I might tell him about it, but I think I would tell him [702] I don't think he has a basis for objection because the other is a by-product.

Q. Of course, if you considered gypsum as a co-product then you would go back and tell your client that it was improper?

A. If everything had been put to the one co-product that he was involved in and not the other, yes, I would tell him that.

Mr. Rosenberg: I think that is all.

Further Redirect Examination

Q. (Mr. Bennett): Mr. Pryor, was there anything in this article, in this 1920 publication, that you read in the three methods of accounting for by-products being set up, one of which methods, at least one statement concerning that method I read you agreed with, was there anything at all about the situation of a third person or someone other than the manufacturer itself being concerned with the determination of actual cost of production?

Mr. Rosenberg: Just a moment. The witness said he has not read the article so I don't imagine he can say.

The Court: In any event, it did not embody, the testimony did not embody a third person.

Mr. Bennett: The point I wanted to bring out, this article, Your Honor, dealt only with the three methods available to a manufacturer and did not

(Testimony of O. Kenneth Pryor.)

deal with the question of where there is a special problem, which we have involved here.

Q. What method would you consider the best and the most accurate [703] method of accounting for a by-product to determine the actual cost or actual cost of manufacture or production of a by-product?

A. Are you referring to the article that I read in that book?

Q. Yes. Well, never mind that. I say of all the methods that might be employed, assuming there are more than one, which method, either in this book or that otherwise might be suggested to you, do you consider the best method and the most appropriate method for the determination of actual costs of manufacture or actual cost of production of a by-product?

A. I consider the method whereby you do not charge any cost to the cost of manufacture of a by-product unless they are necessary expenses directly and solely attributable to that by-product or those which are ascertainable.

Q. Would any method of accounting that would allow or include indirect costs which would continue even if the by-product was not manufactured but in a less degree but an unascertainable degree, make possible a determination of the actual cost of manufacture?

A. I do not think so.

Q. Would any such method of allocating these indirect charges that would have gone on in any event and in any lessening degree which are unas-

(Testimony of O. Kenneth Pryor.)

certainable, furnish any basis for the determination of the actual advance in the cost of manufacture of the by-product in one twelve-month period over the preceding twelve-month period? [704]

Mr. Rosenberg: Well, I will submit that is completely irrelevant. He is testifying as to what he says is the best accounting practice. We assume that if we use the same method in two periods, if it is the proper method, it is proper for comparative purposes, and if it is improper, it is improper for comparative purposes, and he admitted himself that this business of comparison does not enter into it.

Mr. Bennett: You missed the nature of my question.

Mr. Rosenberg: Then I withdraw the objection.

(The question was read by the Reporter.)

A. (The Witness): I don't think so.

Q. (Mr. Bennett): Would a method suggested as the third method in this book where the purpose of the manufacturer is to determine in relation to his sales as well as his production and operation which would involve all the factors by way of allocations relating to those matters, provide a basis whereby the actual cost of manufacturing of the by-product would be obtained?

A. I do not think so.

Q. As I understood the testimony on recross examination that where conceivable some variations of accounting may be permissible for a manufacturer to suit his own purpose.

(Testimony of O. Kenneth Pryor.)

Mr. Rosenberg: Please don't summarize the witness' testimony. If you want to ask a question, go ahead. I object to this practice of telling the witness what he said and then [705] asking him if that is right.

Mr. Bennett: You have done it constantly.

Mr. Rosenberg: I have been doing nothing but cross-examining up to this point. I have not had a witness on direct. We are here for the eighth day, now. That is my purpose, it is not your purpose.

The Court: I think you asked for four days to try this case. You asked for four days, did you not?

Mr. Bennett: Yes, Your Honor.

The Court: Proceed.

Q. (Mr. Bennett): State whether or not, Mr. Pryor, a system of accounting relative to the cost of production of a by-product that might suit the purpose of the manufacturer would be appropriate where a third person or another person is concerned in that determination and where it is necessary or desirable to determine the actual cost to the manufacturer.

Mr. Rosenberg: I object on the ground it calls for an opinion and conclusion of the witness on a matter that is not a proper subject of expert testimony. It depends upon the contract between the parties in this particular case as to what is or is not proper; by reason of the fact that Pacific is going to be affected, I don't know what he is supposed to be a witness on now, the morals or business ethics or what, but I will—

(Testimony of O. Kenneth Pryor.)

Mr. Bennett: Counsel, you know that is not a proper statement to make. As I understand the matter, the witness [706] stated, or, at least, I understood his statement was that a system of accounting might be appropriate to the purposes of the manufacturer but inappropriate for the actual determination of cost where a third party is involved.

Mr. Rosenberg: If you so understand, it is obvious you don't have to ask him, you don't need to ask him the question.

Mr. Bennett: I thought I could get it in one direct answer rather than to spell it out in a number of answers. I did it for the benefit of the Court. If Your Honor does not think it is necessary, I won't take the time.

Mr. Rosenberg: I withdraw my objection.

The Witness: May I have the question?

(The question was read by the Reporter.)

A. (The Witness): Not necessarily so.

Mr. Bennett: That is all. Thank you.

The Court: Step down.

Mr. Bennett: If Your Honor please, I would like to offer in evidence at this time and read into the record paragraph 10(e) of Defendant's answers to plaintiff's interrogatories:

"Prior to January 1, 1944, all overhead expense was allocated on the basis of operating labor and repair labor expense. Commencing January 1, 1944, and until January 1, 1946, general overhead ex-

pense was allocated on a combined supervision and operating labor basis. Maintenance and engineering costs were [707] allocated on a repair labor basis. Process control and control laboratory costs were allocated on a direct basis with the balance of the costs of these two departments pro-rated over the direct allocation. Commencing January 1, 1946, and during the period from that date to and including June 30, 1946, the same procedure was followed with the exception that general overhead was allocated on a combined operating and repair labor basis. In prior years miscellaneous shipping expenses allocated to gypsum was allocated on a dollar value basis. In June, 1945, miscellaneous shipping expense was charged and allocated to gypsum on a tonnage basis. The above changes were brought about upon the advice of competent accountants for the purpose of improving the book-keeping and accounting records of defendant as related to all products produced by defendant, including gypsum, and to accomplish uniformity of accounting practices between the various units of the defendant company."

Now, I offer that, Your Honor, not as evidence of the truth of the facts stated, but the claim of the company as to what it did and why. Plaintiff rests, Your Honor.

Mr. Bennett: I might say this before I rest, it may well be, as Your Honor has suggested, that the plaintiffs have taken too long in presenting the case here, but I consider the evidence that has been produced here in this case important and a somewhat

unusual litigation, I consider it was not irrelevant [708] or improper.

The Court: Let me give you the right state of mind. If I am not here in this case, it would be some other case. I have to keep in mind the volume of work that we have here in litigation. I put two or three cases over so we could go on with this and dispose of it.

Mr. Bennett: I understand that. I certainly did not intend my statement in any way to mean criticism.

The Court: No, no. If it ever comes to the time that the courts can not be criticized, that will be a sad day.

Mr. Bennett: Far be it from me to criticize any purpose that Your Honor had in mind.

The Court: I never did indulge in the thought that there was any perfection among judges, any more than any other human beings.

Mr. Bennett: That attitude of mind is always a compliment to the individual. I wanted to say, Your Honor, that I think that technically we have gone forward with evidence here that we were not required to do in these classes of case, declaratory judgment actions or declaratory relief suits in which controversies are involved, the determination of which is to be declared by the court, the plaintiff only has the burden of proving the situation that a controversy exists and if not the burden of proof, at least the burden of going forward with the evidence shifts to the other party. The burden in this case of [709] proving what was cost of pro-

duction and manufacture and what are the actual increases was upon the defendant. I will cite Your Honor cases for that, but I will not do it at this time. We thought our position could be made as clear as we could in this chronology and what we thought would be an orderly fashion. If Your Honor desires any authorities on this, each of my points, I will present them.

Mr. Rosenberg: I might say, Your Honor, I am going to disagree entirely with that position of counsel, so I think it might be well to have his authority at this time. It might save argument later on. Counsel has stated to the Court that all that is necessary for a plaintiff in a declaratory relief suit to do is to show that there is a controversy and then the burden of going forward with the evidence is shifted to the other side. My understanding is directly to the contrary, that a person who comes in to court on a suit for declaratory judgment has the burden of proof and he continues to have it throughout the trial, and it may very well be that the position of the parties will be directly reversed by reason of the fact there is a suit for declaratory judgment.

In other words, let us assume a controversy on an insurance policy. If an action were brought on the policy it would be for a beneficiary to bring the suit and carry the burden of proof as to whether or not the insurance company is liable, but if the insurance company elected to avail itself of the [710] benefit of the declaratory relief procedure and comes into court, their positions are entirely

reversed and it becomes the burden of the insurance company to show that it is not liable on the policy, whereas in an action at law on the policy it would be the burden of the beneficiary to prove the insurance company was liable. If counsel has any authorities on those points, I would like to have the benefit of them now. I would like to look at them during the noon recess.

Mr. Bennett: I don't want to do that, counsel, if it is not necessary. Perhaps I should after hearing any statement—I was anticipating a motion that you may not make. I want to say now if we had the burden of proof we have established a prima facie case on the facts now before the Court.

We rest.

The Court: What is your motion?

Mr. Rosenberg: I am going to move for a judgment, Your Honor. I don't think I can argue with him a minute and a half before 12:00 o'clock. I would suggest that we adjourn until 2:00.

The Court: Be prepared, then, for that motion.

Mr. Bennett: Will counsel state his motion now?

Mr. Rosenberg: I am going to ask for a——

The Court: So the other side will be in position to meet it, state it. [711]

Mr. Rosenberg: I will make a motion for a judgment in favor of defendant upon our affirmative defenses, if the Court please, that the contract on its face is invalid for uncertainty. I believe the

evidence that has been adduced by the plaintiff shows conclusively that it is.

Mr. Bennett: Is that the scope of your motion?

Mr. Rosenberg: That's right. I will elaborate a little on it.

Mr. Bennett: We will be prepared to meet that, Your Honor.

The Court: Recess until 2:00 o'clock.

(Thereupon an adjournment was taken until 2:00 o'clock p.m.) [712]

Friday, December 19, 1947, 2:00 o'clock p.m.

The Court: You may proceed.

Mr. Rosenberg: If Your Honor please, before I proceed with the motion, I would like to renew my motion to strike Exhibit 5, which was admitted subject to motion to strike, and which Your Honor may recall is a letter written under date of June 5, 1936, which is approximately seven months prior to the execution of this contract by Mr. Barrows, who was the then president of California Chemical Company, to the Pacific Portland Cement Company. At the time this letter was introduced I objected to it on the ground it was incompetent, irrelevant and immaterial and would come within the parol evidence rule because the obvious purpose of offering it was to prove that the parties intended or had an agreement that was contrary to that which was expressed in the written document.

(Motion argued.)

The Court: The offer is made in relation to paragraph 11. I will limit the testimony to paragraph 11 and I will allow it.

Mr. Bennett: That is, you do not grant the motion to strike?

The Court: No, the motion to strike will be denied, but I want it known I am limiting this testimony to paragraph 11.

Mr. Bennett: I have no objection, Your Honor, to considering the whole letter in relation to its contents. [713]

The Court: I limited the testimony, so you won't be misled now, to paragraph 11.

Mr. Rosenberg: I think, if Your Honor please, if I understand Your Honor——

The Court: I asked counsel to indicate the purpose of this offer.

Mr. Rosenberg: Yes.

The Court: He picked up paragraph 11, made an argument and contended it went to the weight of the testimony. On that basis I am allowing it.

Mr. Rosenberg: At this time, if the Court please, the defendant moves for a ruling on its affirmative defenses 3 and 4, the affirmative defense to the first cause of action, which are incorporated by reference in the other causes of action as set forth in the complaint.

(Motion argued.)

The Court: I am prepared to rule at this time. For the purpose of the record, the motion will be denied at this time. You may renew it.

(Thereupon an adjournment was taken until Tuesday, December 23, 1947, at 10:00 o'clock a. m.) [714]

Tuesday, December 23, 1947, 10:00 o'clock a.m.

STANLEY H. BARROWS,

called as a witness on behalf of the defendant, being first duly sworn, testified as follows:

Q. (The Clerk): Will you state your name?

A. Stanley H. Barrows.

Direct Examination

Q. (Mr. Rosenberg): Where do you live, Mr. Barrows?

A. I live in Carson City, Nevada.

Q. You formerly resided in San Francisco, did you? A. Yes.

Q. You were formerly connected with the California Chemical Company, were you?

A. I was president of the California Chemical Company.

Q. When, approximately, was that corporation created?

A. I believe the record will show that it was incorporated in 1923.

Q. In what business was that corporation engaged?

A. Production, principally, of magnesium chloride.

Q. Did it operate a plant?

A. Yes, it had a plant at Chula Vista, California.

Q. That plant was engaged primarily in producing what? A. Magnesium chloride.

Q. From what material was the magnesium chloride produced?

(Testimony of Stanley H. Barrows.)

A. It was extracted from salt bitterns. That is the residue, [715] the liquid residue which accrues in the manufacture of solar salt.

Q. In other words, that is bittern, is it?

A. Bittern.

Q. The end product in that plant at Chula Vista was what? Magnesium chloride, did you say?

A. Correct.

Mr. Bennett: What is the purpose of all this counsel, if I may ask?

Mr. Rosenberg: It is preliminary, Mr. Bennett.

Q. Did the California Chemical Company subsequently construct a new plant at a different location?

A. It constructed a chemical plant at Newark, California.

Q. Is that the same plant, that is, the same location as the plant presently conducted by the Westvaco Chlorine Products Corporation?

A. Correct.

Q. When was that plant first constructed at Newark?

A. I believe the first operations began about 1930 or 1931.

Q. What was the nature of that operation?

A. We extracted principally bromine from the bitterns.

Q. At the time that you first started operations at Newark, California, was that the only product produced, the bromine?

A. Yes, at that time.

(Testimony of Stanley H. Barrows.)

Q. For how long did that continue?

A. Well, it continued from that time up to the present. [716]

Q. No, I mean the situation where the only product being produced was bromine.

A. Well, it continued until we constructed what we termed Sea Water, Major Sea Water Plant. That is what the name was. In that plant we produced magnesium oxide, gypsum and lime.

Q. When was that plant constructed, the so-called Sea Water Plant?

A. As near as I can recall, the construction of that began in the spring of 1937 and it went into operation I think about December of the same year, or perhaps January, 1938.

Q. So do I understand that from some time approximately in 1930 until some time toward the end of 1937 the principal operation of the Newark plant was the recovery of bromine from bittern?

A. That is right.

Q. During that period of time, after the bromine was recovered from the bittern, what was done with the bittern?

A. I believe it was released back into the bay, or wasted.

Q. When did the California Chemical Company first consider going into the production of magnesium and gypsum?

A. When did they first consider it?

Q. Yes.

A. Well, they considered it for a number of

(Testimony of Stanley H. Barrows.)

years prior to the time this plant was built, at various stages of pilot planting.

Q. What do you mean by "pilot planting"?

A. A pilot plant is a small scale plant which is put into operation [717] to check laboratory findings in a small manufacturing operation.

Q. Would you say it is in the nature of an experimental plant?

A. An experimental plant.

Q. When did California Chemical first start pilot planting, as you term it, the production of magnesium and gypsum?

A. I could not give the date. It first started back in Porterville. We shipped the bitters down in tank cars. That was the early work. And then it was transferred on a larger scale to the plant at Newark, and that would be, as near as I could remember, that plant started about 1935, the first part of 1935.

Q. Then during what period did you continue the experimental operation in the pilot plant regarding the production of magnesium and gypsum?

A. That operated something over two years before we began construction of the Major Sea Water Plant.

Q. When you speak of the Major Sea Water Plant, can you tell me whether that is the present plant of the Westvaco Chlorine Products Corporation at Newark that you are speaking of?

A. That is.

Q. That is exclusive of the bromine plant, is it?

(Testimony of Stanley H. Barrows.)

A. Correct.

Q. What experimental work or what exploratory work did you do in this pilot plant in connection with the production of gypsum?

A. I could not tell what the exact operations were, but we did [718] develop a process to make a good grade of gypsum. That was one of the purposes for which the pilot plant was constructed.

Q. What investigation did you make as to the marketability of the product?

A. After the process had been adopted or developed, we took the gypsum made in that pilot plant and shipped that to various users of gypsum in order to determine whether that product which was made in the pilot plant would be successful in their own commercial scale operations. In other words, it is a checking of the quality, the usability and the suitability of the gypsum.

We also carried on—we had tests made in commercial scale plants for construction purposes, using gypsum for, for instance, plaster, cement blocks, roofing slabs. We also had it tested for soil treatment, agriculture soil treatment. There are large quantities of gypsum used in the treatment of soil. We checked all of those with our pilot plant-made gypsum and received satisfactory reports.

Q. What effect, if any, did the results of these tests and explorations have upon your plans for this new so-called Sea Water Plant?

Mr. Bennett: I think that is leading and suggestive, incompetent, irrelevant, and immaterial, if your Honor please.

(Testimony of Stanley H. Barrows.)

The Court: The objection is overruled. You may answer.

The Witness: You say I may answer? [719]

The Court: Yes.

A. Well, it had a very important bearing, because that is exactly what these tests were made for. We would not go ahead and put a very large sum of money into a new plant without having products that we expected to make tested in commercial operations. For instance, our present contract, the Pacific Portland Cement Company, tested our stuff in their commercial scales at Redwood City and approved the material, and that is when our negotiations began, after they found it was satisfactory for the manufacture of cement.

Mr. Bennett: I move to strike out the witness' answer as volunteer and self-serving.

The Court: Read the question and answer.

(Question and answer read.)

The Court: The question and answer may stand. Proceed.

Q. (Mr. Rosenberg): You mentioned the contract. Can you tell me whether or not the construction of the Sea Water Plant at Newark, California, was commenced before or after the contract between Pacific Portland Cement Company and California Chemical Company was entered into?

A. The plant was not started until after we had entered into a contract with Pacific Portland Cement, assuring the sale of our product.

Q. Let me ask you, are you a chemist, Mr. Barrows? A. No. [720]

(Testimony of Stanley H. Barrows.)

Mr. Rosenberg: I do not suppose, Mr. Bennett, there is any necessity for me tracing through the California Chemical Company to the Westvaco Chlorine Products Corporation? We are agreed that Westvaco is the successor of the California Chemical Company?

Mr. Bennett: The pleadings and your statements so far have indicated that. I do not see that there could be any question about it.

The Court: Let the record so show. Have you entered into a stipulation in that respect?

Mr. Bennett: Yes, your Honor. I think our pleadings state that the defendant Westvaco has succeeded to all the rights and obligations of California Chemical Company.

The Court: Very well, proceed.

Q. (Mr. Rosenberg): Mr. Barrows, you are familiar, are you, with the contract which is the subject-matter of this litigation?

A. In a general sense, yes. I have run through it.

Mr. Rosenberg: At this time, if the Court please, I would like to offer in evidence the original contract which is the subject-matter of the suit. There is a copy of the contract attached to the complaint, and it admitted in the answer. My only purpose in offering the original contract is to show that it is contained in the legal back of Pillsbury, Madison & Sutro. I imagine that can be stipulated and there will be [721] no need of putting the contract in. Is that true, Mr. Bennett?

Mr. Bennett: The copy you have shown me has a back on it of the Pillsbury, Madison & Sutro firm,

(Testimony of Stanley H. Barrows.)

but there is something very unusual about it, because it would appear that the back had been perhaps on some other document and had been removed. I do not know how that can be explained. I suggest, counsel, if that is your only purpose, you might have the document further identified.

Mr. Rosenberg: Yes.

Q. Mr. Barrows, I show you what purports to be a contract dated January 29, 1937, between Pacific Portland Cement Company and California Chemical Company, and ask you if you recognize the signature of William N. Williams.

A. Yes, that is his signature.

Q. And he was an officer of California Chemical Company at the time this contract was entered into?

A. Yes, he was vice president.

Q. Have you seen this contract before, the original? A. Yes, I have seen this.

Q. Are you in a position to state whether the document, when you first received it, bore the back that is contained on it?

Mr. Bennett: I think, counsel——

Q. (Mr. Rosenberg): Did it have a back on it?

A. No—— [722]

Mr. Rosenberg: Is there any question about this? Your own Mr. Colton testified that it was Pillsbury, Madison & Sutro.

Mr. Bennett: Just a minute, counsel.

Mr. Rosenberg: You are trying to raise an implication, to which I take exception, Mr. Bennett, that this back has been switched, when you know

(Testimony of Stanley H. Barrows.)

of your own knowledge, and your own client told you, that Pillsbury, Madison & Sutro prepared this contract, and you raise a nasty implication like that, and I resent it.

Mr. Bennett: All right, you can resent all you want, counsel, and I resent the statement you made here, too.

The Court: Keep in mind gentlemen, the holiday season is here and I won't be comforted by any sharp controversies.

Mr. Bennett: I think this was a little hasty. Counsel knows I was not charging him with anything. It is just another example of what has gone on several times before.

The Court: Proceed, gentlemen.

Mr. Rosenberg: You will have Mr. Colton back, will you, or has he left?

Mr. Bennett: Yes.

Mr. Rosenberg: He left?

Mr. Bennett: He is not here now. I can have him back if you desire.

Mr. Rosenberg: Is he in town? [723-4]

Mr. Bennett: No, he is up in Nevada. I told him not to come back until he heard from us.

Mr. Rosenberg: I will ask that this be admitted.

The Court: Let it be admitted and marked.

(The document referred to was thereupon received in evidence and marked Defendant's Exhibit G.)

(Testimony of Stanley H. Barrows.)

DEFENDANT'S EXHIBIT G
AGREEMENT

This Agreement, made this 29th day of January, 1937, by and between Pacific Portland Cement Company, a California corporation, hereinafter called "Pacific," a party of the first part, and California Chemical Company, a Delaware corporation, hereinafter called "California," party of the second part.

Witnesseth:

Whereas, California contemplates the erection of a plant located on Canal Head at Newark, California, primarily designed to produce magnesium oxide in its various forms, which plant will produce as a by-product substantial quantities of gypsum, and

Whereas, Pacific is desirous of purchasing from California certain of the gypsum produced at said plant;

Now, Therefore, the parties hereto, in consideration of the mutual promises and covenants herein contained, promise and agree as follows, to wit:

(1) California agrees that it will sell and deliver to Pacific, and Pacific agrees that it will purchase and receive from California, the entire output of by-product gypsum produced by California at its said plant in excess of California's requirements for use or sale of gypsum for chemical, pharmaceutical, or scientific purposes, which requirements of California shall not exceed four thousand (4,000) tons per annum. It is the intent of this agreement that Pacific will purchase from California, and California

(Testimony of Stanley H. Barrows.)

will sell to Pacific, all gypsum produced at said plant which may be available for any use for agricultural, building, or construction purposes, or any other commercial purpose other than for chemical, pharmaceutical, or scientific purposes.

(2) This agreement shall apply to all gypsum produced at said plant up to January 31, 1962; provided, however, that at any time during the first two (2) years of this agreement, upon the giving of written notice by Pacific to California, this agreement may be canceled by Pacific, and that at any time after the first two (2) years Pacific may cancel this agreement on the giving of one year's written notice to California.

(3) Pacific agrees that it will purchase and accept shipments of gypsum so produced in approximately equal monthly quantities. California agrees that on or before the fifteenth day of each month it will notify Pacific in writing of the amount of gypsum which it proposes to produce during the succeeding calendar month, and Pacific shall have the right to refuse to purchase and accept in excess of two thousand (2,000) tons in any one month, such refusal to be exercised in writing on or before the first day of the calendar month during which gypsum in excess of two thousand (2,000) tons per month is to be produced.

California further agrees that it shall give Pacific three (3) months' notice in writing of its intention to produce in excess of twenty thousand (20,000) tons of gypsum in any one calendar year, and Pacific shall have the right to refuse to purchase and

(Testimony of Stanley H. Barrows.)

accept in excess of twenty thousand (20,000) tons in any one calendar year, such refusal to be exercised in writing within thirty (30) days after receipt of notice from California.

In the event that Pacific shall exercise its right to refuse to purchase and accept in excess of two thousand (2,000) tons in any one month, or twenty thousand (20,000) tons in any one year, then and in that event California shall have the right to sell the amount so refused for any purpose whatsoever.

(4) Pacific shall pay California for said gypsum two and eighty hundredths dollars (\$2.80) per net ton of two thousand (2,000) pounds loaded bulk on board cars at the plant of California at Newark, California. Payments shall be made on the fifteenth day of the month for gypsum loaded during the preceding month.

(5) In the event that any gypsum ($\text{CaSO}_4 \cdot 2\text{H}_2\text{O}$) tendered to Pacific hereunder shall not be within two per cent (2%) in gypsum ($\text{CaSO}_4 \cdot 2\text{H}_2\text{O}$) content of, or if it shall not conform to, the chemical analysis and specification attached hereto, marked Exhibit "A," and hereby made a part hereof, then and in that event Pacific shall have the option as to any such gypsum ($\text{CaSO}_4 \cdot 2\text{H}_2\text{O}$) either to (1) refuse to accept and pay for such gypsum ($\text{CaSO}_4 \cdot 2\text{H}_2\text{O}$), or (2) accept such gypsum ($\text{CaSO}_4 \cdot 2\text{H}_2\text{O}$) and pay therefor ten cents (10c) per ton less than the price provided for in paragraph (4) above for each per cent which the said gypsum

(Testimony of Stanley H. Barrows.)

($\text{CaSO}_4 \cdot 2\text{H}_2\text{O}$) falls below the said chemical analysis in gypsum ($\text{CaSO}_4 \cdot 2\text{H}_2\text{O}$) content.

(6) In the event that California's cost of production of gypsum for any twelve (12) months' period during the term hereof shall increase five per cent (5%) above its average cost of production of gypsum for the preceding twelve (12) months' period, then and in that event California shall have the right, upon giving sixty (60) days' written notice to Pacific, to increase the price payable hereunder for gypsum thereafter delivered hereunder in an amount not to exceed the actual advance in California's cost of manufacture; provided that in no event may more than one such increase be made in any one calendar year.

California shall keep books of account and records showing its production cost of gypsum, and such books of account and records relating to the production cost of gypsum shall be open to inspection to Pacific at all reasonable times in order to enable Pacific to confirm the correctness of any advance in price permissible under this paragraph.

(7) All new or additional state or federal taxes levied subsequent to the date hereof on the sales covered by this agreement shall be added by California to the sales price and paid to California by Pacific.

(8) This agreement shall bind and inure in favor of the parties hereto, their respective successors and assigns. California is hereby given the express right to assign this agreement to any cor-

(Testimony of Stanley H. Barrows.)

poration of equal financial responsibility with California, or which may operate the plant contemplated to be operated hereunder, with substantially the same properties and plant; otherwise California shall have no right to assign this agreement or any of its rights or obligations hereunder without the written consent of Pacific.

In Witness Whereof, the parties hereto have caused these presents to be executed as of the day and year first hereinabove written.

[Seal] PACIFIC PORTLAND
CEMENT COMPANY,
By /s/ ROBT. B. HENDERSON,
President.

/s/ A. H. CANVIN,
Secretary.
CALIFORNIA CHEMICAL
COMPANY,
By /s/ WILLIAM N. WILLIAMS,
Vice President.

EXHIBIT "A"

Gypsum Analysis and Specification

The gypsum ($\text{CaSO}_4 \cdot 2\text{H}_2\text{O}$) purchased under this contract shall conform to the following analysis:

Silica.....	SiO_2	.06
Ferric oxide.....	Fe_2O_3	.06
Aluminum oxide.....	Al_2O_3	.02
Calcium oxide.....	CaO	32.32
Magnesium oxide.....	MgO	.29
Sulphur trioxide.....	SO_3	45.89
Ignition loss. Comb.....	$\text{H}_2\text{O} + \text{CO}_2$	20.70
		<hr/>
		99.34%

(Testimony of Stanley H. Barrows.)

Combined water content=20.40%.

Gypsum content ($\text{CaSO}_4 \cdot 2\text{H}_2\text{O}$) calculated from combined water=97.51%.

Methods of analysis shall conform with the A.S.T.M. "Standard Methods for Testing Gypsum and Gypsum Products" No. C-26-33; except that free moisture shall be determined by drying at room temperature to constant weight.

Free moisture shall not exceed 1%. Water soluble salts other than CaSO_4 shall not exceed 0.4%.

Q. (Mr. Rosenberg): Mr. Barrows, what, if anything, did you have to do with the negotiation of this contract?

A. I had a great deal to do. I believe that I carried on a very large part of the negotiations, all except the last three days, I think it was.

Q. With whom did you carry on those negotiations?

A. Mr. Colton, who then was vice-president, and production manager of Pacific Portland Cement Company.

Q. When did those negotiations commence, approximately?

A. By memory I would say in May, 1936

Q. Can you just trace for us in a general way the course of your conversations with Mr. Colton?

A. To make it as brief as possible——

Mr. Bennett: Just one minute. It seems to me, your Honor, that is going pretty far abroad to permit self-serving declarations, incompetent and irrelevant evidence, and I object to it on that basis.

Mr. Rosenberg: I have asked him to give me conversations, not self-serving declarations. [725]

(Testimony of Stanley H. Barrows.)

Mr. Bennett: That opens the door to start in with their first negotiations and goes through the series of things. Is it your purpose, counsel, by this witness' testimony, to direct this evidence to or in connection with the letter of June 5, 1936, that is in evidence here?

Mr. Rosenberg: I certainly do.

Mr. Bennett: Is that the purpose of this testimony?

Mr. Rosenberg: That is part of the purpose.

Mr. Bennett: What is the other purpose?

Mr. Rosenberg: I think that will develop when we go into it.

Mr. Bennett: I object to it as incompetent, irrelevant, and immaterial.

Mr. Rosenberg: The purpose is obviously this, if the Court please: Mr. Bennett put in a letter, to which I took exception, and I made a motion to strike, and the court denied the motion, which was for the apparent purpose of showing what the intention of the parties was, although the letter was dated seven months before the contract was entered into, and Mr. Bennett also chose for some reason not to fill the gap between the date of that letter and the time of the execution of that contract. As long as that letter has gone in, and perhaps to fill that gap, the purpose of this testimony is to show what actually transpired between the parties.

The Court: Read the question. [726]

Mr. Bennett: The question relates to prior to the letter.

(Testimony of Stanley H. Barrows.)

Mr. Rosenberg: Maybe I would like to start a little earlier than you did, Mr. Bennett. That is my privilege.

The Court: Read the question.

(Question read.)

Mr. Rosenberg: These are the negotiations between the parties leading up to the execution of this contract, if the Court please.

The Court: You may answer. The objection may be overruled.

A. Mr. Colton and I had informally discussed the possibilities of a contract between his company and California Chemical Company, contemplating the purchase of gypsum, which we produced—I would say—I would say purchased by his company of gypsum which we produced. After their tests, and they approved the gypsum, Mr. Colton proposed to me that I write a letter roughly outlining the terms under which we would contract for the sale of the gypsum. I did write such a letter.

Q. (By Mr. Rosenberg): I will show you a letter that has been introduced as Plaintiff's Exhibit 5, or which, rather, purports to be a copy of a letter dated June 5, 1936, addressed by you to Pacific Portland Cement Company, attention of Mr. Colton. Is that the letter to which you refer?

A. Yes.

Q. What contract were you speaking of there? What was the subject-matter of which you were speaking? [727]

(Testimony of Stanley H. Barrows.)

Mr. Bennett: Just a moment. I think that ordinarily the documents speaks for itself, and for that reason I would object to this question as incompetent, irrelevant, and immaterial.

Mr. Rosenberg: I will withdraw it, Mr. Bennett. When your Honor admitted this letter I believe you stated you were restricting it to paragraph 11.

The Court: It was admitted only as to the one paragraph of the letter.

Mr. Rosenberg: I really feel, if the Court please, if the letter is going to be admitted, it should be admitted in its entirety, because I believe it shows what the subject-matter of the correspondence was about, which could not be gleaned just from that single paragraph, and if the letter is in, I think that it should be in in its entirety and be considered in its entirety, and I presume Mr. Bennett would have no objection to that.

Mr. Bennett: I take it you are making the request now—I told the court all I was concerned with in the letter particularly was paragraph No. 11, the statement, which the court recalls, stated the contract would contain certain price protection clauses against increases in labor, fuel and supplies. I do not dispute counsel's contention, your Honor, that this paragraph 11 that I was concerned with should, of course, be considered in some relation to the context of the letter, [728] and if he suggests, or proposes that the whole letter be considered in relation to 11, I will not offer any objection to that.

(Testimony of Stanley H. Barrows.)

The Court: Let it be admitted and marked.

Mr. Bennett: It is already in evidence.

The Court: It may go in now in its entirety. It was limited to one paragraph.

The Witness: I had not been permitted, however, to complete my answer to Mr. Rosenberg's question.

Q. (By Mr. Rosenberg): All right.

A. A letter of this sort was a very rough, tentative outline suggesting conditions which would be discussed and added to and perhaps some taken out. It was just an outline of what we could start to negotiate a contract on.

Q. Following this date of June 5, 1936, were there any further discussions between you and Mr. Colton with reference to the subject-matter of the letter?

A. Yes, there were many, many meetings.

Q. Can you tell me the subject-matter of your discussions, what was discussed between you, your best recollection as to the substance of those conversations?

A. There were so many things discussed, you might say every paragraph of the contract was ripped over, back and forth.

Mr. Rosenberg: Mr. Kaapecke, may I have the original of the letter of September 18, 1936?

Mr. Kaapecke: I have copies here. I do not happen to have [729] the original.

Mr. Rosenberg: You have a photostatic copy of it, do you?

(Testimony of Stanley H. Barrows.)

Mr. Kaapeke: I doubt if I have it with me.

Mr. Rosenberg: Will you furnish that to me this afternoon?

Mr. Kaapeke: I think so.

Mr. Rosenberg: With the enclosure?

Mr. Kaapeke: Yes. [729-a]

Q. Mr. Barrows, I show you what purports to be a copy of a letter dated September 18, 1936, to Mr. Colton, and signed California Chemical Company by yourself, attached to which is a form of agreement between Pacific Portland Cement Company and California Chemical Company. I ask you if you recall having written such a letter containing such an enclosure to Mr. Colton.

A. Yes; that is a letter and I would judge that this is a copy of the first rough attempt to put the conditions in contractual form. When you have discussions, those things are submitted, discussed and objections by one or the other, changes put in.

Mr. Rosenberg: I ask that this be marked for identification at this time. I am not offering it in evidence, Your Honor. I would like to compare it with the original that Mr. Kaapeke has offered to furnish.

The Court: Admitted for the purpose of identification.

(The copy of letter dated September 18, 1936, to Mr. Colton from California Chemical Company was thereupon marked Defendant's Exhibit H for identification.)

(Testimony of Stanley H. Barrows.)

Q. (By Mr. Rosenberg): Between June 5, 1936, and September 18, 1936, had there been discussions between you and Mr. Colton with reference to the contract mentioned in your letter of June 5, 1936?

A. I am not able to answer that with positiveness. I have the feeling that when Mr. Colton received my letter he called me up [730] and had some changes to make that I can't recall.

Q. Can you state whether or not following September 18, 1936, and between that date and January 29, 1937, did you have any further discussion or negotiations with Mr. Colton regarding a contract between his company and yours?

A. Very definitely.

Q. During the course of those conversations or discussions, was a contract discussed in the terms and provisions that would be considered in it?

A. Yes. Most of the clauses were discussed including but not limited to, for instance, the tonnage that was involved, the price involved, and we had wanted a cancelation clause which they objected to and finally I guess we acceded to it and the cost of production and future price.

Q. Do you recall the substance of your discussions with Mr. Colton on the subject of the cost of production?

Mr. Bennett: When and where and who was present and what was said? I think he can answer "yes" or "no" first—

The Witness: I can answer those things.

(Testimony of Stanley H. Barrows.)

Mr. Bennett: Wait. If you will just answer that question, you were asked whether you recall the substance, but before you relate the substance——

The Witness: Please repeat the question.

Q. (By Mr. Rosenberg): Did you discuss with Mr. Colton this matter of cost of production of gypsum? [731] A. Yes.

Q. Can you recall when approximately?

A. On several occasions in the fall of 1936.

Q. Can you recall approximately when you had your last conversation with him on that subject?

A. My recollection, it is pretty hard to think back ten years, but my recollection would be in December, 1936, as near as I can recall.

Q. Do you know where you had that conversation?

A. That was in Mr. Colton's office.

Q. In San Francisco?

A. In San Francisco.

Q. Who was present, if anyone, beside you and Mr. Colton?

A. My recollection is just the two of us.

Mr. Bennett: Pardon me. Just a moment. I am sorry to interrupt. What was the date of this conversation?

Mr. Rosenberg: December, 1936.

Mr. Bennett: Can you fix it any more definitely?

Q. (By Mr. Rosenberg): Can you fix it any more definitely than that?

(Testimony of Stanley H. Barrows.)

A. I might by running over—no, I don't think I could. I don't think there is anything in our files that would show it.

Q. Some time in the month of December, is that your best recollection? A. Yes. [732]

Q. Did you state anyone else was present; I believe you stated——

A. No, there were only the two of us.

Q. What was the conversation between you and Mr. Colton on the subject of cost of production?

A. Well, that was a culmination of several previous talks, also the matter of price. When Mr. Colton would not concede to a cancelation clause, I figured that we ought to be pretty careful about being tied up in a price that we couldn't make out on a long-term contract.

Mr. Bennett: I move to strike all the answer, all the witness' answer on the ground it is not responsive and it is a self-serving declaration.

The Court: Do I understand this was a conversation you had at that time and place?

The Witness: A number of conversations, yes; we argued over if we did not have a cancelation clause, why, we didn't want to be stuck with a price that might embarrass us and cost us a lot of money in the future, so I wanted to be pretty careful about what the cost of production would be.

The Court: Proceed.

Mr. Bennett: That shows in his answer that it was not a conversation. He is relating what was in his mind.

(Testimony of Stanley H. Barrows.)

Q. (By Mr. Rosenberg): Did you tell that to Mr. Colton?

Mr. Bennett: That is self-serving. [733]

The Court: I asked him that myself, was this the conversation at that time and place?

The Witness: I couldn't recall the conversation ten years back and say what the words were, but I know that is the subject.

Q. (By Mr. Rosenberg): But you are telling what you told Mr. Colton, are you?

A. I am telling what we were discussing.

Mr. Bennett: I don't want to delay this, but I think the very nature of this shows the propriety of the objection.

The Court: In the interest of time, I will sustain the objection. Reframe the question.

Mr. Bennett: May the last——

The Court: It may go out.

Q. (By Mr. Rosenberg): Mr. Barrows, did you and Mr. Colton have any discussion or conversation regarding the price provisions relating to the sale of gypsum by California Chemical Company to Pacific Portland Cement? A. Yes.

Mr. Bennett: When?

Mr. Rosenberg: Well, you ask him, Mr. Bennett. You take it up. Maybe you can get——

Mr. Bennett: Oh, now, don't be smart.

Q. (By the Court): When did you have that conversation?

A. During the fall of 1936 on several occasions it was discussed. [734]

(Testimony of Stanley H. Barrows.)

Q. During the month of December?

A. It culminated in the month, but it started and went on through October, November and December, because that was a matter we discussed thoroughly.

Q. Tell us as near as you have a recollection of what was said during that period of time in relation to it.

A. The discussions came down to conditions referring to production, cost of production, items of production cost. During this discussion I said, "Well, that is not sufficient, just the items." I said, "I wouldn't be limited to those items, there are other items that go to make up cost of production," and we argued. I mentioned a number of items. He said, "We can't put all these items in." I said, "If we can't do that, then make it the cost of production and we will let the accountant decide what cost of production is." That was the point of the conversation.

Mr. Bennett: May I have that answer read?

(The answer was read by the Reporter.)

Q. (By Mr. Rosenberg): You said to Mr. Colton you would not want to be limited to those particular items. What items do you refer to?

A. Well, I think we put in tentatively at the start—that letter, I believe, of the 25th mentions a few items.

Q. Do you recall the items that you mentioned?

A. No, I couldn't recollect that. [735]

Q. Exhibit 5.

(Testimony of Stanley H. Barrows.)

A. They were not sufficiently clear for a long-term uncancellable contract.

Q. What was Mr. Colton's response to that?

A. I can't relate his response, but it wound up in him saying, "Well, we will just put in cost of production and let it go at that. Cost of production, I presume; I don't know.

Mr. Bennett: I move to strike out the voluntary statement of which we have had so many, which means and so forth——

The Court: What he presumed may go out.

The Witness: If I can amplify that.

The Court: Just a moment.

Q. (By Mr. Rosenberg): Was there anything else there discussed on this subject between you and Mr. Colton?

A. I recall myself suggesting that it be termed cost of production as according to accounting standard practice and I left a note of that before they completed the final contract to Mr. Williams explaining it and that was not put in. Whether I gave him the note or not I don't know, but that was definitely stated.

Q. Between the time that you wrote this letter of September 18, 1936, and January 29, 1937, were there any redrafts of the agreement in the interim?

A. Yes. [736]

Q. Can you state approximately how many there were?

A. I would say two or possibly three.

Q. What would occur when these redrafts would be prepared?

(Testimony of Stanley H. Barrows.)

A. Well, Mr. Colton would scratch, make notes on his copy and I would do the same with mine and we would have a meeting to iron out the items under discussion or approving the items under discussion.

Q. Do you have any recollection of any further conversation with Mr. Colton on the subject of cost of production following December or is the last conversation?

A. I think that was the last one. We agreed at that meeting to put in cost of production.

Mr. Bennett: Now, I move to strike out, "We agreed at that meeting to put in cost of production."

The Court: It may go out.

Mr. Bennett: As involving a conclusion, conjecture.

The Court: It may go out.

Q. (By Mr. Rosenberg): Will you state your best recollection of what was said in that respect?

A. I don't know how to put it in more or less words. We discussed the thing and decided on the terminology, namely, we will have cost of production control that part of the clause that was in our discussion and you come to an agreement when you decide to put something in.

The Court: When you put it in language you come to an [737] agreement, that is a conclusion. You can't spell anything out. Under the law they are entitled to as near as you can relate the con-

(Testimony of Stanley H. Barrows.)

versation had at that time and place, any of it or all of it or what you have a recollection of.

A. Well, I cannot relate that specific conversation ten years back.

The Court: I am not asking you to.

The Witness: I mean, I am answering, I could not tell the words that were used; it is just impossible.

Q. (By Mr. Rosenberg): Can you give us the substance of what was said?

A. I think I have already done that.

Q. Let's do it again. Who suggested the language, cost of production, do you recall?

A. No, I don't. I think we both decided that would cover what we were driving at, the cost of production of gypsum.

Q. In the course of those conversations was it said by either you or Mr. Colton that is the language we will put in the contract? A. Yes.

Q. Did the other party acquiesce and say that would be all right?

Mr. Bennett: This is all leading.

Mr. Rosenberg: Well, you are making a highly technical objection. He is giving a conversation as to what was said [738] after discussing it back and forth, we actually agreed, "Well, we will just put this provision in the contract." Now Mr. Bennett wants him to tell the words that were used.

Mr. Bennett: The witness has said two or three times that he can't recall conversations ten years ago.

(Testimony of Stanley H. Barrows.)

The Witness: Verbatim.

Mr. Bennett: I submit the objection is not highly technical. I further submit this form of question by counsel is leading and suggestive and objectionable particularly in this case.

The Court: Proceed: There is nothing before the Court.

Mr. Rosenberg: That is all.

Mr. Bennett: Are you through, counsel?

Mr. Rosenberg: Yes.

Cross-Examination

By Mr. Bennett:

Q. When did you first have any connection with California Chemical Company, Mr. Barrows?

A. I organized the company.

Q. In 1923? A. Right.

Q. Prior to that time, had you had any interest or connection with a chemical manufacturing concern? A. Not manufacturing, no.

Q. You had been in the chemical industry business?

A. I had been in the magnesite business. [739]

Q. Magnesite business?

A. Yes, mining and producing magnesite.

Q. What concern was that? A. The uses?

Q. No. What company was it?

A. That was the Sierra Magnesite Company.

Q. And you were the organizer and president of California Chemical Company? A. Yes.

Q. You mentioned a plant at Chula Vista and one down at Newark. Did it have any other plant or operation?

(Testimony of Stanley H. Barrows.)

A. This is probably involved, but at the time that this California Chemical Company was in this contract it had taken over the Sierra Magnesite Company and also the National Kellastone Company, a number of other companies, and after the contract consolidated them all in the California Chemical, and then we did have a number of other plants.

Q. You were the principal stockholder?

A. Yes.

Q. In this whole venture of companies?

A. Yes.

Q. In 1937, shortly after this contract in suit here the contract of January 29, 1937, you disposed of all your interests or at least, title to all your interest to the Westvaco Corporation? [740]

A. Yes, we consolidated.

Q. You consolidated them. There was a transfer, according to your understanding, of the physical properties as well as any contractual obligations undertaken by California Chemical Company to the consolidating corporation Westvaco?

A. Correct.

Q. You still have an interest as a stockholder and executive in the defendant corporation, do you not, Mr. Barrows?

A. In Westvaco?

Q. Yes. A. Yes.

Q. As a matter of fact, you are the largest stockholder in Westvaco, are you not?

A. I would rather not answer that.

Mr. Bennett: Well, I think——

(Testimony of Stanley H. Barrows.)

The Witness: I don't think that that is relevant.

Mr. Bennett: I don't want to embarrass you.

The Witness: I have a substantial holding in Westvaco.

The Court: I think that is sufficient for all purposes.

Mr. Bennett: All right, Your Honor.

The Court: The only reason it is admissible at all is any interest he may have in the result of this trial and if he mentions that he has a substantial interest, I think that is sufficient.

Q. (By Mr. Bennett): Westvaco is a large national concern [741] with many plants all over the United States, isn't it? A. Yes.

Q. The term Westvaco was taken from the words West Virginia Company?

A. That's right.

Q. Westvaco has in addition to its New York office, western operation headquarters, taken over this plant which it had formerly had down at Newark; that is correct, isn't it? A. Yes.

Q. In 1931 you were actually producing, in addition to bromine, magnesium products at the plant down at Newark, were you not? A. No.

Q. When was the first time that any magnesium products were produced at the Newark plant?

A. After completion of the plant under discussion, namely, what we termed the Sea Water plant.

Q. You were producing magnesium products during the early 1930's, in 1931 at the Chula Vista plant? A. Yes.

(Testimony of Stanley H. Barrows.)

Q. Was that operation at the Chula Vista plant similar to the later operation at the Newark plant?

A. No, definitely not.

Q. You did not manufacture magnesium from bittern?

A. Yes, but the processes were completely different from the way we produced magnesium down there, it was on a different [742] process than we produced it up here.

Q. Who made the first contract with Pacific Portland or Mr. Colton—Withdraw the question.

You sought and made a proposal to Pacific Portland Cement Company yourself, didn't you, Mr. Barrows, initially?

A. Well, it was pretty informal. We were working——

Q. I am trying to get at, they didn't come to you and seek to buy gypsum, you approached them and proposed to sell gypsum to them.

A. It was made in this light: We are going to build a plant in which we will produce magnesium and gypsum; would you be interested in purchasing the gypsum produced? That is the way it came, and he said, "Well, after we make our tests we will let you know."

Q. The point is, you sought to sell initially rather than Pacific sought to buy this?

A. I would say that was correct.

Q. You also approached the other companies around California and tried to sell them gypsum, too, didn't you?

(Testimony of Stanley H. Barrows.)

A. We approached them in the same way, inquiring whether they would be interested.

Q. What was to be the principal or primary product to be manufactured at this plant at Newark, Mr. Barrows? A. You mean at Newark?

Q. Yes. [743]

A. We figured on the bromine that we were producing as one of the major—I don't think they were considered primary, they were all considered a major product. That is the way we looked at it.

Q. Wasn't it the purpose that you had in mind in building that Newark plant, that it was to be built principally for the purpose of producing magnesium oxide and its related products?

A. This last plant that we are referring to here, it was to produce magnesium and gypsum.

Q. Wasn't the principal and primary purpose of the plant to produce magnesium oxide?

A. Well, I don't think I could answer it in that light. In order to produce magnesium oxide profitably, we have got to produce other things with it. In other words, that was in contemplation for justifying the investment.

The Court: It is time for a recess.

(Recess.) [744]

Q. (By Mr. Bennett): Mr. Barrows, in the manufacture of magnesium oxide it is necessary in an operation involving the basic raw material bittern to remove the sulphate in the bittern water in order to make magnesium oxide, isn't that a fact?

(Testimony of Stanley H. Barrows.)

Mr. Rosenberg: To which I object on the ground it is not proper cross-examination. It is beyond the scope of the direct examination.

Mr. Bennett: Counsel on direct examination had the witness relate the very purposes for which these plants were built. I think this is proper cross-examination, bearing upon the very subject, as I understood it, that was the purpose of the direct examination.

The Court: The objection is overruled. He may answer if he knows.

A. I do not think I am competent to answer the processes by which it can be made. It can be made by several processes from bittern. It can be made from sea water. How they get the sulphate out is a matter of the process adopted.

Q. (By Mr. Bennett): You do know from your own experience in this chemical industry that to manufacture magnesium oxide out of bittern water it is necessary to take the sulphate out before you can produce the magnesium oxide, isn't that true?

A. But there are more than one way to get them out.

Q. Yes. Let us assume there are more than one way, but to produce magnesium oxide you have to take the sulphate out, do you? [745]

A. I presume.

Q. Don't you——

A. I couldn't answer that, myself. Our chemical man can.

(Testimony of Stanley H. Barrows.)

Q. They have explained that to you, and they explained it to you long before this contract of January 29, 1937, did they not, Mr. Barrows?

Mr. Rosenberg: Same objection. The man has testified he is not a chemist, your Honor. Mr. Bennett wants to make a chemist out of him.

Mr. Bennett: He was president of the company who signed this contract, and I think I am at least able to test the question of his knowledge of what he was doing, Mr. Rosenberg, as proper cross-examination.

The Court: You may answer.

The Witness: What was the question?

(Question read.)

The Witness: I do not think that that would ever come up with me, as far as I can remember. In a chemical plant there are so many technical operations, they come in and say something to an executive, and explain this and that, and I would not be able to remember.

Mr. Bennett: May I have the deposition of Mr. Stanley Barrows?

Q. Mr. Barrows, I direct your attention to page 10 of the deposition of yours which was taken on October 25, 1947. I will direct [746] your attention to page 9, beginning at line 7, and continuing on page 10, from line 1 to and including line 26.

A. From 7, you say?

Q. Yes, line 7 on page 9, the rest of page 9, and all of page 10.

A. All right, Mr. Bennett.

(Testimony of Stanley H. Barrows.)

Q. Directing your attention specifically to page 10, line 14, I will ask you whether or not these questions were asked and the answers given you at the time your deposition was taken on October 25, 1947.

Mr. Rosenberg: What is the purpose of this? Is this to impeach something?

Mr. Bennett: It is to show the witness at that time knew what this process was and was able to give the answers, Counsel.

The Witness: I do not think so.

Mr. Bennett: I think the court should determine that.

The Witness: The copy speaks for itself.

The Court: He is entitled to a record. We will proceed under the rules.

Q. (By Mr. Bennett): "Q. Now, in the manufacture of these two products from sea water, magnesium and bromine, there results this product in a rough state, as you mentioned, gypsum?"

A. Yes.

Q. And unless and until it is refined, that gypsum is [747] the by-product of the manufacture of bromine and magnesium?

A. I would think that was correct."

You gave that testimony at the time the deposition was given?

Mr. Rosenberg: I am going to object to that as being incompetent, irrelevant, and immaterial. It does not have the slightest relations to any of the testimony this witness has given, and this is merely

(Testimony of Stanley H. Barrows.)

an effort by indirection to go into on cross-examination matter that is beyond the scope of the direct examination. This witness has not said anything on the subject of whether or not gypsum is a by-product. How does that tend to refute his testimony?

Mr. Bennett: Your Honor, I think it all has a bearing on the very question we are dealing with here. Your Honor will recall that in the two and a half days that Mr. Flick was under cross-examination a great deal of effort by repeated questions was made as to the character of this product, in an attempt to show that it was not in fact a by-product. Now, the matter of contract, these preliminary negotiations, costs, and so forth, have a direct bearing upon this witness' testimony which he gave on direct examination, and these questions are not only germane but they are preliminary to further examination that I wish to direct the witness' attention to. You will recall that the witness said, "Leave this to the accountants as to what the meaning of cost of production is." I think I am [748] entitled to show on cross-examination, as your Honor indicated should not be narrowed to a narrow scope, what this witness was thinking about in the light of what he alleged he was talking about prior to the time the contract was actually executed.

The Court: I will overrule the objection. Proceed.

(Testimony of Stanley H. Barrows.)

Mr. Rosenberg: Then I understand this is asked for the purpose of impeachment, is that right, Mr. Bennett?

Mr. Bennett: This is for the purpose of cross-examining the witness.

Mr. Rosenberg: There are different purposes of cross-examination: one, to elicit evidence, and another to impeach. I submit again, your Honor, this is an attempt by indirection to get into the record questions and answers of this witness which are beyond the scope of the direct examination. If Mr. Bennett wants to ask the same questions now that he asked in the deposition, he is perfectly entitled to do so, and I have my opportunity to object. If the court overrules the objection and the witness answers, and the answer is contrary to the answer he gave in the deposition, then it is perfectly proper to ask him whether he gave a contrary answer in the deposition, but to incorporate in a question, "Were you asked these questions and did you give these answers," which have no relation to the direct testimony, I submit is improper cross-examination. Why doesn't Mr. Bennett ask the witness [749] the same questions that he asked him in the deposition, give me an opportunity to object, and if your Honor overrules my objection, let the witness answer, and if it is not the same as his answer in the deposition, that is the time to read from the deposition.

Mr. Bennett: Your Honor, I think the witness' testimony answers completely all that counsel has

(Testimony of Stanley H. Barrows.)
said. Before I referred to this deposition I asked this witness with reference to the manufacture of magnesium oxide, whether it was necessary to take sulphates out, and he said he did not say anything about it.

The Court: No, he said he assumed they did. The record will so show.

Mr. Bennett: Perhaps I should stand corrected on that point, but an indication the witness did not show——

The Court: However, in the interest of time I will allow him to answer. Read the question.

(The last question was read by the reporter.)

The Court: You may answer.

The Witness: I gave that testimony. However, this process that we develop, intending to develop the gypsum, that is not the only way you can get sulphates out. We did that to make an income from gypsum. That was the purpose of developing that process.

Mr. Bennett: Your Honor, I move to strike that answer [750] of the witness as being volunteer.

The Court: He can explain his answer. Let the question and answer stand.

Q. (By Mr. Bennett): In the manufacture of magnesium oxide in accordance with the plan of operation at the contemplated plant at Newark, to produce that magnesium oxide sometime along the process it would be necessary to remove from the product being processed calcium sulphate that was precipitated in the tanks, would it not, Mr. Barrows?

(Testimony of Stanley H. Barrows.)

A. Yes, I would think so. I would rather have these questions asked of a chemist, but we do take it out. In fact, we made it in order to take it out.

Q. However, in the manufacture of magnesium oxide it is necessary to remove in this process of manufacture calcium sulphate, is that not so?

A. The process was we adopted.

Q. If there was no market for this calcium sulphate it would be simply a waste product or a by-product in the course of manufacture, is that not so?

A. If there were no market for it, that is correct.

Q. Prior to the building of this plant at Newark, you had been producing, in addition to bromine, magnesium products, had you not?

A. Yes, but not at Newark.

Q. Not at Newark? [751]

A. Not at Newark commercially.

Q. Did you know a Dr. Max Y. Seaton?

A. Yes.

Q. In 1931 what, if any, connection did Dr. Max Y. Seaton have with your California Chemical Corporation?

A. Was that a question? I did not get that.

(Question read.)

A. (Continuing): He was vice president and technical director.

Q. I show you Plaintiff's Exhibit 3, which is a photostat taken from this publication of "Chemical and Metallurgical Engineering," of Novem-

(Testimony of Stanley H. Barrows.)

ber, 1931. You have seen this publication and article entitled, "Bromine and Magnesium Compounds, Drawn From Western Bays and Hills," by Max Y. Seaton, California Chemical Corporation, Newark, California, have you not?

A. Yes, I have seen it many years ago.

Q. I direct your attention to the notation that appears on the right-hand portion of the sheet that follows:

"Left: Flow sheet of magnesia products recovery as practiced by the California Chemical Corporation." Then the title, "Below: This lime plant at the Newark works yields an oyster-shell lime of exceptional qualities."

And below that:

"Center: General view of bromine and magnesia products plants at Newark, California."

A. Yes. [752]

Q. Does that refresh your recollection at all as to whether you were producing magnesium products?

A. Sure. That does not refer—that is the pilot plant.

Q. But at the pilot plant you were manufacturing both bromine and magnesia products?

A. No, the bromine plant was a plant by itself. It does not show in this picture. The magnesia products were being produced on a pilot plant basis and not shipped commercially, for those tests to which I have previously referred.

Q. Which is the magnesia plant picture?

(Testimony of Stanley H. Barrows.)

A. This is the magnesia pilot plant.

Q. The picture on the right?

A. That is right—no, that is the lime plant. The magnesia plant does not show here, but there was a small plant of that order in which we produced magnesia.

Q. Dr. Seaton's article states, "Center:—" "referring to this center picture here—" "General view of bromine and magnesia products plant at Newark, California." Look at the center picture and perhaps you can see the magnesia plant there.

A. I do not recognize the magnesia plant. I do not think it shows here. It may give it that term, but I can tell you what that magnesia products plant was. It was for making this pilot plant—it was not used commercially. We shipped nothing commercially until this new plant was built. I am sure plenty of evidence can be produced to confirm that. [753]

Mr. Bennett: I move to strike out the witness' voluntary statement that he feels plenty of evidence can be obtained.

The Court: If it is not a fact, let us find that out.

Mr. Bennett: Yes, I am trying to do that.

Q. (By the Court): There was not any produced commercially? A. Definitely no.

The Court: That is his definite statement.

The Witness: That is right. None, whatever.

Q. (By Mr. Bennett): Which is the bromine plant? A. That is the bromine there.

(Testimony of Stanley H. Barrows.)

Q. You mean on the left center picture is the bromine?

A. And this could be another picture of it. I can't quite place that.

Q. Can you tell me what the right center picture is? A. Is that the right center?

Q. Yes.

A. Let me get on another pair of glasses. These are a little bit weak.

Q. (By the Court): Is this one any better? I have another copy here.

A. That may be the pilot plant.

Q. (By Mr. Bennett): For the magnesia?

A. For the magnesia, yes. It probably is. I know that building there (indicating). We had a very small kiln, and if that is the head gates for getting our lime, and so forth, in [754] there, then it is. That is the magnesia products plant, capable of producing only a few hundred pounds a day.

Q. I am directing your attention to this statement in Dr. Seaton's article, which appears on page 640 of the magazine:

"Exit liquor from the bromine recovery towers has essentially the same composition as the raw bittern with the exception that its small bromine content has been replaced with chlorine. Some 3 per cent dilution by condensed steam also has occurred. Both Newark and Chula Vista plants process this liquor for magnesium chloride recovery. This step involves the concentration of the bittern in multiple-effect, salt-type vacuum evapo-

(Testimony of Stanley H. Barrows.)

rators. Sodium chloride separate hot, while cooling of the evaporated liquor (in batch coolers at Chula Vista; continuous coolers at Newark) gives an essentially pure, saturated solution of magnesium chloride, which is separated from magnesium sulphate, potash, and residual sodium salts by settling and centrifuging. The magnesium chloride solution is further evaporated in open pans until it has the composition——”

A. You see, there is a process of getting the sulphates out without making gypsum.

Q. Continuing my quotation: “— $\text{MgCl}_2 \cdot 6\text{H}_2\text{O}$, and this hot liquid is chilled to give solid, flake or powdered commercial magnesium chloride.”

A. Right.

Q. What was done with the magnesium products that were produced at the Newark plant from 1931 on, Mr. Barrows?

A. They were all used for various test purposes. We were doing a lot of work making special refractory brick in the East, and we made special types of magnesia and set out the batches for them to try out.

I can say your impression is incorrect. There was no magnesium products made at Newark commercially before this Major Sea Water Plant.

Q. I am not deriving impressions as evidence.

A. I just wanted to get it clear.

Q. I am reading from what Dr. Seaton has said: I direct your attention again to this following state-

(Testimony of Stanley H. Barrows.)

ment on page 640 under the title of "Other Salts Now Recovered."

"The present magnesium chloride market which can logically be served from a Pacific Coast plant will absorb but a fraction of the total magnesium values present in the bittern now being received, which quantity is regularly increasing as salt consumption of the West Coast steadily grows. Accordingly, after extensive laboratory investigation and some two years' pilot operation, a small plant for recovery of these values in other forms is now in production and a large plant is being engineered. Basically, the method employed is that of conversion [756] of soluble magnesium values to magnesium hydrate through reaction with lime, and further processing of this magnesium hydrate. The scheme can claim no novelty in conception, as it has been repeatedly suggested for the treatment of Stassfurt residues and for Michigan and Ohio River brines."

At that time, back in 1931, you were contemplating and had done engineering work for the building of this larger plant, had you not, Mr. Barrows?

A. Seaton says so. I think it was very preliminary work, though.

Q. Do you dispute what Dr. Seaton said, that "a large plant is being engineered"?

A. Yes, I would dispute that.

Q. In other words, that statement by him was untrue?

A. I think that was for publication, that they were working in a general way.

(Testimony of Stanley H. Barrows.)

Q. In other words, you contend that in that statement Dr. Seaton was misrepresenting the facts?

A. He was painting a rosy picture, I guess.

Q. He was your chief executive down there at the time, was he?

A. Yes, at Newark, but not for the company.

Q. Did you ever tell him that he had made mis-statements in this article?

A. I don't think so. I don't know that I ever picked up that reference. Our men may have been doing some engineering in a very preliminary way.

Q. Now, I also call your attention to this further statement by Dr. Seaton on page 640 of the article, Plaintiff's Exhibit 3: "The byproduct gypsum from the process through operation of favorable location factors, is marketable at a profit instead of being a valueless waste."

Do you agree with that statement by Dr. Seaton?

A. Well, I think that needs amplification. It is a valueless waste as it comes out but you have to put in a lot of equipment and put in processes to manufacture it into useful gypsum.

Q. You have to dry it and grind it?

A. You have to treat it with acid, you have to wash it, you have to dry it, you have to grind it, a number of factors that make it useful for commercial gypsum.

Q. In any event, in 1931 and in 1937 and 1938 after this new plant was in operation in the manufacture of the magnesium products, there was of

(Testimony of Stanley H. Barrows.)

necessity a removal of calcium sulphate necessary to the manufacture of the magnesium products; isn't that correct?

A. Yes, because we chose that process.

Q. That was the same process that was being followed back in [758] 1931 when Dr. Seaton wrote this article?

A. That was the pilot plant that led up to this process.

Q. So in 1931, six years before this contract was entered into, the same thing occurred down at the pilot plant that later occurred with this plant in the process of manufacturing magnesium oxide, you had this calcium sulphate which, unless it was further processed, was simply a waste.

A. That's right, nothing, but we did process it and use it for test purposes.

Q. Back in 1931 when the article was written, what was the favorable location factor that made these waste products marketable?

The Witness: Is that of any value to the thing we are trying to get at here?

Mr. Bennett: I think the Court will decide and determine that.

The Witness: Well, those——

Mr. Rosenberg: I submit, Mr. Bennett, it is improper to cross-examine this witness on what somebody else wrote 16 years ago.

The Court: As I said, that goes to the weight of the testimony. I may indicate that for the pur-

(Testimony of Stanley H. Barrows.)

pose of the record at this time so that nobody is misled on the subject.

The Witness: Shall I answer?

The Court: Read the question. [759]

(Question read.)

The Witness: Shall I answer?

The Court: Yes.

A. To the best of my knowledge, having selected this plant which is going to use lime for eliminating the sulphates, we were located on San Francisco Bay, close to very large deposits of pure lime which could be purchased at a low cost; we built a canal to bring it up to the plant so it would be moved at a very low cost, and the bitterns also concentrated at the same point at a low cost through pipe lines from the salt plant, the market for gypsum was immediately favorable because the freight rate to move gypsum from Newark to the Redwood City plant was 50 cents a ton whereas in the rest of the gypsum coming into this territory, carried \$3.50 or \$4.00 a ton freight without the cost of the gypsum. It made a combination of favorable factors, that is what made us decide to produce gypsum.

Q. (By Mr. Bennett): In other words, the location of the plant made it possible to market this gypsum? A. Yes.

Q. At a profit instead of being a valueless waste?

A. Certainly.

Q. The only cement plant at Redwood City is the plant of the plaintiff Pacific Portland Cement Company, isn't it? A. Correct. [760]

(Testimony of Stanley H. Barrows.)

Q. Do you know how much relative tonnage of magnesium oxide is produced in relation to the amount of this byproduct gypsum?

A. I wouldn't like to have my figures go into the record because I am not sure enough of them, but if I might approximate, I would think perhaps 40 to 50 thousand tons of gypsum would be produced and probably a like quantity of magnesium.

Q. What is the value of magnesium oxide per ton, Mr. Barrows?

Mr. Rosenberg: If the Court please—

Mr. Bennett: I will withdraw the question.

Q. In 1937, January 29, 1937, as well as during the year 1936, what was the value or market price of magnesium oxide?

Mr. Rosenberg: I object. This is obviously not cross-examination.

Mr. Bennett: It is preliminary to show this plant down there was built primarily for the purpose of magnesium oxide. They built the plant and it produced what was simply a byproduct, as the contract states. It all has a bearing upon the discussion, or the testimony that this witness gave on direct examination. It is preliminary and I am coming specifically to these conversations that the witness had with Mr. Colton.

Mr. Rosenberg: I submit, if the Court please, I put this witness on the stand to testify to certain subjects and I think his cross-examination should be confined to that. I have only one thing in mind,

(Testimony of Stanley H. Barrows.)

frankly, I know Mr. Barrows has not [761] been in good health and he is supposed to go home in the afternoon and rest. I was hoping his cross-examination should be completed by the time we adjourn at noon.

The Court: There is no reason why we cannot conclude with the witness. I will sustain the objection. With that thought in mind let us proceed.

Q. (By Mr. Bennett): When you wrote this letter of June 5, 1936, to Mr. Colton, you proposed that you sell the gypsum delivered, loaded on cars for \$2.60 a ton, didn't you?

A. I think the record will show what it was. Whatever——

Q. The letter said that.

A. Whatever is there is what we agreed to.

Q. You said here in this letter, paragraph 5:

“We would offer to sell you all of the gypsum produced by said plant except 3,000 tons for which we reserve the privilege of marketing for chemical uses. This would leave an estimated 15,000 tons per year of gypsum which we would offer you at \$2.60 per ton, loaded on cars at our plant at Newark.”

A. Yes, but I think we later discussed that——

Mr. Rosenberg: Just a minute. There is no question. What are you asking him?

Mr. Bennett: Preliminarily I am asking if that was the price.

A. That was in the preliminary— I think that was changed in the final draft, if I recall. [762]

(Testimony of Stanley H. Barrows.)

Q. Yes, that was the first quoted price.

A. That is my recollection.

Q. Then you stated here in paragraph 11 of this letter:

“Contract would contain certain price protection clauses to guard against increases in labor, fuel and supplies.”

At that time, Mr. Barrows, all you were concerned with was that in this 30-year contract which later became a 20-year contract, that you would be protected against increases only in labor, fuel and supplies?

A. Yes, but that contemplated we would have a cancelation right so if it ever got out of hand, we would cancel; that is why we got into this cost discussion later, for better protection.

Q. But at that time the thing you were thinking about in so far as a price protection clause, was increases in labor, fuel and supplies involved in the manufacture of this gypsum?

A. With the protection of cancelation.

Q. Let us leave aside the cancelation.

The Court: You can't very well.

The Witness: You can't.

The Court: If counsel wants to have him say——

Mr. Bennett: He is stating it but I am asking him about the particular costs. Remember, Your Honor, during the direct examination of this witness he was permitted to discuss at great length the various costs that he had discussed with Mr.

(Testimony of Stanley H. Barrows.)

Colton. [763] I think I am entitled, or should be entitled, according to my understanding, to discuss the changes, if any.

The Court: I have indicated previously I have allowed the widest latitude and I purpose to do it again. Here is a witness called, he was an executive, he acted in this contract; it follows that within reasonable limits cross-examination should be confined to his direct examination. We have gone into this article and a number of other matters that had no relation to his testimony. However, in the interest of time you can ask him.

Mr. Bennett: Maybe I have been very remiss in not having properly explained to Your Honor the exact purpose I had. I certainly would not have gone into it unless there was some purpose in doing it. I think Your Honor will at least credit me with that amount of intelligence, but maybe I did not make myself clear to Your Honor. The examination of the witness on cross-examination——

The Court: I would like to make it clear to you and counsel on the other side, we have consumed twice as much time as you asked for in this case. I have allowed the widest latitude so that nobody would be offended because he did not have an opportunity to be heard. I think I tried to indicate that before. I repeat it again. With that thought in mind, proceed.

Q. (By Mr. Bennett): Aside from this cancellation feature which [764] you say you had in

(Testimony of Stanley H. Barrows.)

mind, the only cost, the particular items of cost that you were concerned with at that time were the items of labor, fuel and supplies; is that correct?

Mr. Rosenberg: At the time when he wrote the letter?

Mr. Bennett: Yes.

Mr. Rosenberg: I will so stipulate.

Mr. Bennett: All right.

Mr. Rosenberg: The letter is the best evidence.

Mr. Bennett: I am cross-examining. Remember counsel's cross-examination of Mr. Flick, it took two long days over a wide field of subject matter.

The Court: Well, you consumed most of that time yourself.

Mr. Bennett: I have not consumed two days yet. I have just had this witness.

Mr. Rosenberg: You had him on direct for four days.

The Court: You can't compare this witness with other witnesses. However, I don't want to discuss these matters. Proceed. He so stipulated. Proceed.

Q. (By Mr. Bennett): On September 18, when you sent this draft of agreement to Mr. Colton, you were still concerned only with price advances in labor, transportation, fuel or supplies, weren't you?

A. If that contains a cancelation clause that was the protection there against incomplete listing of the items of increased cost. [765]

(Testimony of Stanley H. Barrows.)

Q. Will you please point out to me where the cancelation is as proposed by you in this September 18 agreement?

Mr. Rosenberg: Let me do that. I think I can do that quicker than the witness, if you do not object.

Paragraph 12: "It is further understood and agreed that California shall have the right to cancel this agreement at any time upon giving written notice to Pacific of its intention so to do, by delivering such written notice to said Pacific at least one year prior to the date of cancelation."

Q. (By Mr. Bennett): I address your attention to paragraph 6, Mr. Barrows.

Mr. Rosenberg: That is not in evidence.

Mr. Bennett: Well, it is marked for identification. Do you want to put it in evidence?

Mr. Rosenberg: No. I want to see the original.

Mr. Bennett: Well, I have no objection to it going in evidence.

Mr. Rosenberg: No. I prefer to have it go in evidence in correct form.

Mr. Bennett: All right.

Q. This draft that you proposed and submitted to Mr. Colton stating, "The prices hereinabove stipulated to be paid by Pacific for gypsum, quick lime and hydrated lime, are based upon the average direct cost to California to produce the materials covered by this agreement during the first year's operation [766] of the contemplated new plant proposed to be erected at Canal Head, Newark, Cali-

(Testimony of Stanley H. Barrows.)

ifornia, and it is therefore understood and agreed in the event of price advances and labor, transportation, fuel or supplies resulting in an increase of 5 per cent or more in cost above the first year's average direct cost hereinabove referred to, f.o.b. car shipping point, then and in that event California shall have the right to increase the price to Pacific to the extent of the increase of the said average direct production cost for lime or gypsum."

Now, did you write that language or was that language written by your attorney?

A. That was written by my attorney. I did not follow you very well, it was pretty involved.

Q. Well, you read this paragraph 6 when your deposition was taken last October, didn't you?

A. I don't remember. I mean, I am not trying to evade, but I just don't—

Q. So this language was the language used by your attorney?

A. In the first rough draft, yes.

Q. You state here that, "The prices hereinabove stipulated to be paid by Pacific for gypsum," which was—

A. \$2.60.

Q. \$2.80 per ton was based upon the average direct cost to California to produce the material covered by this agreement. What did you mean—

Mr. Rosenberg: Read it. Don't stop in the middle of the sentence. "—average direct cost to California to produce the materials covered by this agreement during the first year's operation of the contemplated new plant proposed to be erected"—

(Testimony of Stanley H. Barrows.)

Mr. Bennett: I have read it once. I will read it again if you want.

Mr. Rosenberg: I don't care as long as the witness knows what is in there.

The Witness: Well, why put in so much time on this when this was not the contract. The contract represents the discussions between Colton and myself, what we arrived at.

Q. (By Mr. Bennett): Now, I would like to know how you determined this average direct cost to produce the material in order to determine this contract price of \$2.80.

A. Don't ask me. I suppose our accountants would determine it. You mean that \$2.80?

Q. Yes.

A. I would think our man Seaton had figured the gypsum could be produced for that and that included some reasonable profit. That is a short-cut.

Q. When you submitted this draft to Mr. Colton, it was your understanding—by the way, "price hereinabove stipulated * * * are based upon the average direct cost to California to produce" gypsum?

A. Yes, because we couldn't get—if the prices got out of hand, [768] got out of line, we would cancel the contract. That is what I understood.

Q. The point is now, the direct cost as you understood it and you referred to in this paragraph 6.

A. I am not an accountant. My understanding of direct costs would be labor, fuel and supplies and supplies are pretty broad.

(Testimony of Stanley H. Barrows.)

Q. Would you say, though, generally it took the costs that were necessary—— A. Yes.

Q. ——to the process by drying, grinding or any other thing that was necessary to the calcium sulphate after its separation from the main raw material?

A. I would rather not get involved in a technical discussion.

Q. You submitted this draft to Mr. Colton; I want to get what your understanding was of direct costs.

A. Direct costs were for labor, fuel and supplies.

Q. It was upon that basis of your direct costs that this contract, proposed contract price of \$2.80 a ton was based; is that it?

A. Right. The direct costs at that time.

Q. You offered to sell the gypsum at that price. That was your proposal of the price, \$2.80, subject to all these other conditions? A. Yes.

Q. You said, Mr. Barrows, that during the conversation with [769] Mr. Colton later on, that there was some discussion about what costs should go in and what costs should not be considered.

The Court: Is there any hope of getting through with this witness this morning?

Mr. Bennett: I think it will take perhaps five or ten minutes at the most, but I hate in a matter of this importance to forego—I do not feel I am doing justice to my client.

(Testimony of Stanley H. Barrows.)

The Court: I don't think you need to apologize to anyone for your presentation of this case, much less the Court.

(Discussion off the record as to the next appearance of this witness and a recess taken until 2:00 o'clock this afternoon.) [770]

Tuesday, December 23, 1947, 2:00 o'Clock P.M.

FRED MELHASE

called as a witness on behalf of the defendants, being first duly sworn, testified as follows:

Direct Examination

By Mr. Rosenberg:

Q. Where do you live, Mr. Melhase?

A. Newark, California.

Q. What is your profession?

A. A chemist.

Q. By whom are you employed?

A. The Westvaco Chlorine Products Corporation.

Q. How long have you been in the employ of that corporation?

A. Since 1933. At that time it was known as the California Chemical Company.

Q. Have you been continuously in the employ of the California Chemical Company and its successor Westvaco Chlorine Products Company ever since 1933?

A. That is correct.

Q. Will you just give us a brief statement of your education and experience as a chemist?

(Testimony of Fred Melhase.)

A. I graduated from the University of California in 1932 with a B.S. degree in chemistry. I went to work for Westvaco in 1933. I believe it was in September of 1933. I have been employed there ever since. [771]

Q. In what capacity were you originally employed? What were your duties?

A. I originally went to work for the California Chemical Company as an operator in a pilot plant which was being built at that time. Actually I worked as a laborer in the plant, the pilot plant, while it was being built.

Q. Then after the plant was built, what were your duties?

A. I was an operator in the plant for about a year.

Q. What do you mean by an operator, Mr. Melhase?

A. Well, one who controls the operation of the process—in other words, turns the valves and so on in a chemical plant.

Q. Will you explain what that pilot plant that you speak of was? What processes were taking place in that plant?

A. That was a plant that was built primarily to investigate the technical phases of a process for producing gypsum and magnesia and also to determine the economic value of those products.

Q. How long did you continue as an operator in the pilot plant?

A. About a year, I believe.

(Testimony of Fred Melhase.)

Q. Then what duties did you take up?

A. At that time I went into the research department as a research chemist.

Q. How long did you continue in that employment?

A. From about 1934 to 1943, as I recall.

Q. What were your functions and duties in the research laboratory? [772]

A. My functions were to work, help work out the technical phases of the pilot plant operation.

Q. And then after the new plant was constructed in 1937, did you perform the same services in relation to the operation of the new plant?

A. Largely so.

Q. And then you say you continued in the research laboratory until 1943, did you say?

A. I believe so, yes.

Q. What has your position with the company been and your duties since that date?

A. Since that date I have been in charge of the process control department and the control laboratory.

Q. Will you explain what the functions of the process control department and the process control laboratory are?

A. The function of the control laboratory is to analyze raw materials, intermediate and finished products, so that proper judgment can be exercised in controlling the operation of the plant and also the quality of the finished products.

(Testimony of Fred Melhase.)

Q. Does that cover generally the scope of the process control department?

A. The process control department observes the operation of the plant on a day-to-day basis in order to improve the efficiency, improve or at least keep up the quality of our finished products, and if possible, to lower costs of production. [773]

Q. Let me ask you, is the gypsum that is produced at the Newark plant tested and analyzed in the laboratory? It is.

Q. Which laboratory is that?

A. The control laboratory.

Q. Will you explain in a general way, Mr. Melhase, the processes at the Newark plant of the Westvaco Chlorine Products Corporation, starting with the time that the raw bittern comes into the plant and follow it in its course throughout the plant, and in connection there with also, will you advise us as to what this bittern is in fact, what is the chemical composition of it, and then trace its course through the plant in a general way?

A. This bittern, as we call it, is a product that was originally a waste, I believe, from a salt company around Newark. It is composed largely of magnesium sulphate, magnesium chloride, sodium chloride, potassium chloride, bromine and practically all the minor elements that are present in sea water.

As we receive the bittern from the Leslie Salt Company, it is stored in large earthen storage ponds, which hold about a year's supply of bittern.

(Testimony of Fred Melhase.)

From these storage ponds it is transferred as needed into three small concrete feed ponds. As it is introduced into those feed ponds, it is acidified with sulphuric acid. From the feed ponds the bittern is pumped to the bromine plant and is there stripped of its bromine content by chlorine and steam. As the bittern leaves the bromine plant, it [774] contains more acid than the original feed bittern, and therefore must be neutralized partially with lime before it can be used further.

After leaving the bromine plant, it is pumped to the gypsum plant or the gypsum department, and in case the bromine towers are not operating the bittern is pumped directly from these concrete feed ponds to the gypsum department. At the gypsum department it is mixed with what we call calcium chloride bittern, which precipitates the sulphates as gypsum and produces what we call the magnesium chloride bittern. After this magnesium chloride——

Mr. Bennett: May I interrupt for a moment? I hate to delay things but I did not quite have this last answer clear and it would aid me.

The Court: Read the answer.

(Record read.)

The Witness: After the magnesium chloride is separated from the gypsum in large settler tanks, a portion of it is wasted and the remainder is transferred to the magnesia department, where it is treated with lime, which precipitates the magnesium hydroxide and forms what we call a calcium chlor-

(Testimony of Fred Melhase.)

ide bittern. All of this calcium chloride bittern, or as much as we can recover, is returned to the gypsum department and it is used there to precipitate more sulphates, more gypsum from the incoming debrominated bittern or acidified raw bittern. [775]

Q. What is the chemical symbol for gypsum?

A. $\text{CaSO}_4 \cdot 2\text{H}_2\text{O}$.

Q. There has been some mention here in the testimony of magnesium oxide. Will you explain what that is and where that comes out, if at all, in the plant at Newark?

A. Magnesium Oxide—the chemical term for it is MgO —and it is produced from the magnesium hydroxide, which is precipitated with lime and there after purified.

Q. What are the products or what is the product that comes out of the magnesium plant? What do you call that? A. Magnesia.

Q. Getting back to this magnesium chloride, I believe you stated that after the gypsum has been taken out in the gypsum department, you have what you call the magnesium chloride bittern.

A. That is correct.

Q. And that in turn goes to the magnesia department?

A. Not all of it. Part of it is wasted.

Q. But the part that goes to the magnesia department, is that the material from which the magnesia is extracted? A. That is right.

Q. You say that a part of it is wasted. Will you explain what you mean by that?

(Testimony of Fred Melhase.)

A. I merely mean that we discard roughly half, a little less than half of that magnesium chloride, that is produced when the [776] gypsum is precipitated. That probably goes back into the Bay. We just dump it out.

Q. What is the reason for that?

A. We do not need all the magnesium chloride bittern.

Q. Do you extract from the bittern the maximum quantity of gypsum that may be produced therefrom?

A. Yes, we do.

Q. Do you extract or recover from the bittern the maximum amount of magnesium that may be recovered therefrom?

A. No.

Q. Is the amount of gypsum that you recover dependent upon the amount of magnesium that you produce?

A. Not completely so, no.

Q. Will you explain what you mean by that?

A. Could I have that question again?

(Question read.)

A. Well, to produce some of this magnesium, it is necessary to remove the sulphates from the bittern, but in our operation we not only remove that portion of the sulphates but also the sulphates from all the bittern that enters the plant.

Q. (Mr. Rosenberg): And then that leaves you, does it, with the magnesia chloride bittern?

A. That is right.

Q. And I believe you stated that you do not utilize all of the magnesia chloride bittern that results from the gypsum [777] operation because you

(Testimony of Fred Melhase.)

have no need to recover that quantity of magnesium, is that right? A. That is correct.

Q. What did you say is done with it?

A. Part of it is wasted.

Q. What is that?

The Court: Half of it is utilized and the other half goes into the Bay.

Q. (Mr. Rosenberg): Does the Westvaco Chlorine Products Company operate a plant at Chula Vista, California? A. It does.

Q. What is the nature of that operation there?

Mr. Bennett: Now, wait a minute. What is the purpose of that, counsel?

Mr. Rosenberg: This is preliminary.

Mr. Bennett: I know when I said the same thing——

Mr. Rosenberg: All right. I will state the purpose. I want to show that although in your discourse you have taken the position that this is something that is produced off the primary product, I want to show that at Chula Vista, California, we operate a chemical plant where magnesia chloride is the end product and there is no further processing from that point on; so that it is not true, as Mr. Bennett said, that this is something that is produced for the primary product and incidental to the recovery of magnesium oxide. At Chula Vista, California, [778] we operate a plant for the express purpose of producing magnesium chloride and we do not follow through and make magnesium out of it.

(Testimony of Fred Melhase.)

Mr. Bennett: Your Honor, I think that explanation shows the utter irrelevancy of his testimony.

The Court: For that limited purpose I will allow it. Proceed.

Q. (Mr. Rosenberg): Does Westvaco operate a chemical plant at Chula Vista, California?

A. Yes.

Q. Will you explain what process is there?

A. The process there is to recover magnesium chloride from the bitters that are produced at Chula Vista.

Q. Is that the end of the process at Chula Vista? A. It is.

Q. So I understand you do not further process the magnesium chloride and recover magnesium from it?

A. No, it is sold there as liquid magnesium chloride or as flake magnesium chloride.

Q. Do you produce any gypsum in the course of your operation at the Chula Vista plant?

A. We do not.

Q. Do you get the sulphate out of the bitttern?

A. We take the sulphate out as magnesium sulphate during the evaporation of the bitttern. [779]

Q. And that removes the sulphate from the bitttern, does it? A. It does.

Q. Will you explain what the purpose is of adding sulphuric acid to the bitttern?

A. When the bromine towers are operating, the purpose of the sulphuric acid is to increase the chlorine efficiency in the bromine plant to inhibit the chlorine from hydraulizing.

(Testimony of Fred Melhase.)

Q. (The Court): I do not follow that. Will you explain that answer?

A. I will go over it again. The purpose of the sulphuric acid, the addition of sulphuric acid to the bittern, when the bromine plant is operating, is to improve the chlorine efficiency. Chlorine is more expensive than sulphuric acid. Does that explain it?

The Court: Proceed.

Q. (Mr. Rosenberg): And is it necessary to the recovery of bromine that you add the sulphuric acid to the bittern?

A. It is necessary to the extent that we want to improve the chlorine efficiency.

Q. What function, if any, does the sulphuric acid play in the production of gypsum?

A. The function of the sulphuric acid in the production of gypsum is to decrease the amount of organic material that is precipitated with the gypsum and to alter the shape and the size of the gypsum crystals which facilitate its further [780] purification and washing, drying, and so forth.

Q. When the bromine department at the Newark plant is not operating, is it necessary, in your opinion as a chemist, to use sulphuric acid for the purpose of producing gypsum? A. Yes.

Q. Will you state whether or not in your opinion you could produce magnesium oxide without introducing sulphuric acid into the bittern?

A. Yes, magnesium oxide could be produced without the use of sulphuric acid.

(Testimony of Fred Melhase.)

Q. Do you know whether you have conducted any experiment or any test at the Newark plant for the purpose of determining whether or not you can produce specification gypsum without using sulphuric acid in the bittern?

A. Yes, we have. In order to verify our previous conclusions regarding the necessity of using sulphuric acid for the production of gypsum, we conducted a test—I believe it was in October of this year—in which we deliberately left out the sulphuric acid in order to see whether the gypsum could be produced economically under such conditions. We found that it was not economical to do so because as a result of leaving out the sulphuric acid our filter cloth blinded very rapidly.

Q. (The Court): You mean by that what?

A. Plugged up.

Q. (Mr. Rosenberg): Have you finished your answer, Mr. [781] Melhase?

A. I do not believe so.

The Court: Read the answer as far as he had gone.

(Record read.)

The Witness: As a result of this blinding, the filter picked up an uneven cake, which threw a veritable load on our drying and made the drying of the gypsum very difficult.

Q. (Mr. Rosenberg): Mr. Melhase, I will show you Defendant's Exhibit G, which is the contract between Pacific Portland Cement Company and California Chemical Company, and direct your at-

(Testimony of Fred Melhase.)

tention to Exhibit A thereof, which is titled, "Gypsum Analysis and Specification." Are you familiar with the gypsum specifications provided in that exhibit and as a part of that contract?

A. Yes, I am.

Q. Will you state whether or not——

The Court: Pardon me. Raise your voice, Mr. Melhase, so you can be heard.

Q. (Mr. Rosenberg): Will you state whether or not under those specifications it is necessary in the production of gypsum to comply with those specifications that the amount of magnesium in the gypsum is limited to a certain amount or a certain percentage?

A. Yes, it is necessary to limit the amount of magnesium oxide in the gypsum to a certain quantity. [782]

Q. And what is specified?

A. .29 of a per cent.

Mr. Bennett: Isn't that all covered by the contract?

Mr. Rosenberg: I do not know, Mr. Bennett.

The Court: You expect me to construe the contract. I need all the information I can get, particularly when we get in the chemical field; I will confess my limitation on that score.

Mr. Bennett: Very well, Your Honor. If Your Honor wishes to hear that.

The Court: You may have had the enjoyment of going through this chemical field some time or other, but on the journey I missed that.

(Testimony of Fred Melhase.)

Mr. Bennett: Your Honor still knows more about it than I do.

The Court: Proceed, counsel.

Q. (Mr. Rosenberg): Will you state whether or not, Mr. Melhase, in order to make gypsum that will meet the specifications provided in that contract, it is necessary to remove the magnesium from the bittern?

A. It is necessary to separate the magnesium chloride from the gypsum that is produced, yes.

Q. Would you as a chemist consider that the sulphate in the bittern is an impurity?

A. I would not consider the sulphate in the bittern as an [783] impurity as such. It is merely one of the constituents of the bittern.

Q. Would you consider the gypsum in its raw state and before it has been ground and filtered and dried as a valueless waste?

A. No, I would not consider it as a valueless waste. It could be stored out in the open some place in a stock pile and later on someone could come along and process that gypsum and make a salable product out of it.

Q. Mr. Melhase, I show you an article that states it is from the Pacific Chemical and Metallurgical Industries, issued October, 1938, entitled "Bromine, Lime, Magnesium, Gypsum; a running description and pictorial record of their production from bittern in shell by Pacific Chlorine Products Corporation at Newark, California," and directing your attention to the section which is designated, "Gyp-

(Testimony of Fred Melhase.)

sum," and specifically the pictures opposite that page, I ask you if you can identify those pictures and tell me what they portray.

Mr. Bennett: Just a moment, Your Honor. Again I am confronted with the problem of not wishing to have the Court precluded from having all light on this subject, but at the same time I am confronted with the necessity of perhaps objecting to evidence as not in the proper form. This matter of photographs, their use and introduction in evidence, as Your Honor knows, for several reasons is limited by certain requirements. I understand counsel's purpose is to get before the Court a [784] pictorial view of what they content is a so-called gypsum plant or that portion of the plant down at Newark where certain processes involved in this case are carried on, but I have never seen it. There is no way I can check it, and there is a question whether those pictures are taken to scale and accurately represent the situation, and for that reason I am going to object to them on the ground that they are incompetent, irrelevant and immaterial and not the best evidence.

Q. (The Court): What is this magazine article and these photographs?

A. Those are pictures of our magnesia or the gypsum portion of our plant. I do not know that they all are. I recognize some of them.

The Court: What is the purpose of them?

Mr. Rosenberg: The point was it might be helpful to the Court to see what the gypsum plant consists of, if Your Honor please.

(Testimony of Fred Melhase.)

The Court: If I am in doubt about the plant or have any difficulty on that score, I will take a trip down to Newark.

Mr. Bennett: I wanted to take a trip down there but we could not agree, Your Honor.

The Court: I may go down myself with the consent of both sides.

Mr. Bennett: I would welcome that.

The Court: However, unless I change my view, there will be no necessity of going down there. Proceed, gentlemen. [785]

Mr. Bennett: What happened to the picture that you have just shown——

Mr. Rosenberg: I have it.

Mr. Bennett: I think we ought to have it marked for identification. After all, you have shown it to the court.

Mr. Rosenberg: But I have not offered it. Yes, I am sorry.

Mr. Bennett: After all, you have shown it to the court.

The Court: Let it be admitted and marked.

Mr. Bennett: It was over my objection.

Mr. Rosenberg: I did not show it over your objection. You say I showed it to the court.

Mr. Bennett: I thought you did.

Mr. Rosenberg: Well, you are wrong again.

Mr. Bennett: I withdraw the words "you showed it to the court." You handed it up.

The Court: The court helped himself to it.

(Testimony of Fred Melhase.)

(The photograph was marked Defendant's Exhibit I for Identification.)

Q. Mr. Rosenberg: Mr. Melhase, will you explain as briefly as you can to the court the methods employed at the Newark plant in sampling and testing the gypsum that is produced there?

A. We control the quality of our gypsum by means of shift samples. The shift——

The Court: You control what? [786]

A. The quality, we control the quality of our gypsum by shift samples. These shift samples consist of a number of grab samples that are taken by the operator at regular intervals during the shift. We place these in containers which at the end of a shift are taken to the laboratory and the samples thoroughly mixed, and then analyzed for ignition loss, chloride, alkalinity. At the end of the day the shift composites are made up into a daily composite, which are saved until the end of the week; then the daily composites are made up into a weekly composite on a weighted average base. A portion of the weekly composite, I believe, is submitted to the Pacific Portland Cement Company for their analysis.

Q. In your opinion as a chemist, does that method of separating and testing in that way offer a fair criterion of the general quality of the output of the gypsum department?

A. I think that it does, yes.

Q. When you are operating at Newark but not

(Testimony of Fred Melhase.)

producing bromine, what happens to the bromine contained in the bittern?

A. It is wasted, it goes back into the bay, along with the exit bittern.

Q. Just one further question. In these chemical processes here is it necessary to produce gypsum in order to produce magnesium chloride?

A. No, it is not necessary to produce gypsum.

Mr. Rosenberg: That is all. [787]

Cross-Examination

Q. (Mr. Bennett): Is it necessary to remove the calcium sulphate—I will withdraw that. Is it necessary to remove the sulphates from the calcium sulphate in order to produce gypsum?

A. In order to produce gypsum?

Q. Not gypsum, but magnesium chloride.

A. The bittern which we have is composed of both calcium sulphate and magnesium chloride, that bittern which is used, a portion of the bittern which is used for the production of magnesia, the sulphates must be removed from——

The Court: You will have to talk louder than that. You can talk louder than that when you are at the plant, can't you?

Q. (Mr. Bennett): You have been here during this whole trial, haven't you?

A. I have been here during a good portion of it, not all of it.

Q. You have been here during the time that both myself and Mr. Rosenberg, your company's

(Testimony of Fred Melhase.)

counsel, were discussing this chart, Plaintiff's Exhibit 16, For Identification?

A. I believe so, yes.

Q. In the bittern water as it comes to you, or as you have it in your storage tanks, there is a chemical substance known as magnesium sulphate; is that correct?

A. You can assume that it is magnesium sulphate. It is present there as magnesium ions and sulphate ions. [788]

Q. Yes. To manufacture magnesium oxide you have to remove the sulphates or separate the sulphates away from the magnesium, do you not?

A. Yes, and a portion of the bittern which is used for the production of magnesium, the sulphates must be removed.

Q. Let's forget for a minute we are making any gypsum or calcium sulphate, that we are just making magnesium oxide. In accordance with the practice that you follow at Newark, magnesium oxide is the primary product for which that plant was designed, wasn't it?

Mr. Rosenberg: I object to that as not proper cross-examination.

Mr. Bennett: This whole examination has been pointed up, as I understand it, that they built a plant there to produce mainly gypsum, that is the inference I get from the story. I want to show that was not the case. The inference is sought to be drawn that gypsum is not what the contract states,

(Testimony of Fred Melhase.)

a by-product. Otherwise, I don't know what the witness has been offered for.

The Court: I will allow the question. Overruled.

(The question was read by the reporter.)

A. (The Witness): No, I would say it was not. The product for which this plant was designed and built, the plant was designed and built for both products, gypsum and magnesium oxide. [789]

Q. (Mr. Bennett): Well, the primary or principal product was magnesium oxide, wasn't it?

A. I would consider them all as products.

Q. I asked you which was the main or primary product to be produced, magnesium oxide or gypsum?

Mr. Rosenberg: I object on the ground it is not intelligible. You tell the witness upon what standard he has to testify to determine whether or not something is primary or principal.

Mr. Bennett: Well, counsel, the witness must know perfectly well, which is the primary product.

The Court: If he knows he may answer.

The Witness: I think it will depend on a point of view, if you are considering it only as a magnesium oxide plant then that would be your main product, but I don't think that is the case here. I think the plant was built to produce both, and also bromine. You might call one or the other a secondary product, depending upon the economic value.

Q. (Mr. Bennett): The economic value of the total amount of magnesium oxide produced in any

(Testimony of Fred Melhase.)

one year is at least many times greater than the total value of the gypsum produced there, isn't it?

A. I don't know. That is something that the management has to do with.

Q. Do you know the total that is produced of magnesium oxide in [790] relation to——

A. They are roughly the same.

Q. Let us consider them roughly the same. You do know the magnesium oxide is a much more valuable product, don't you, according to its market price?

A. According to its market price it may be, but according to net return to the company it may not be.

Q. Well, you are talking now about net return, is that what you mean? A. Yes.

Q. Again forget about making any gypsum down there, but using the same process that you follow in the actual manufacture of this magnesium product, it is necessary to get the sulphates out of the magnesium in order to get magnesium oxide; isn't it?

A. You take the sulphates out of the bittern, too.

Q. That is an essential step in the manufacture of magnesium oxide, isn't it?

A. It is essential in this process, yes.

Q. You can't make magnesium oxide without taking away the sulphates from it, can you?

A. No. You can not make gypsum without taking the magnesium chloride away from it.

(Testimony of Fred Melhase.)

Mr. Bennett: I move to strike out the last part of the witness' answer. [791]

The Court: It may go out.

Q. (Mr. Bennett): When you get down into your final step of making the magnesium oxide if there was any sulphate contained in that product that sulphate would then be an impurity, wouldn't it?

A. That is correct. However, in the process of producing that magnesium oxide from the magnesium hydroxide the sulphates would probably be driven off in the process.

Q. Yes. You can't make magnesium oxide without first driving off the sulphates?

A. What I mean there by that answer is the sulphates, in order to make magnesium oxide out of magnesium hydroxide, it is necessary to calcine that magnesium hydroxide at a very high temperature. In that process of calcination the sulphates are driven off.

Q. Yes. That driving off of the sulphates, is at least one of the steps necessary to make magnesium oxide, isn't it?

A. The final magnesium oxide cannot contain very much sulphate——

Q. If it does contain sulphate the sulphate is considered an impurity from a chemical point of view, isn't it, in magnesium oxide?

A. That is correct.

Q. The very purpose, at least, of taking out the sulphates from the magnesia in the bittern water is

(Testimony of Fred Melhase.)

to remove the impurity from [792] the end product of magnesium oxide, isn't it?

A. I wouldn't say it was to remove an impurity from the magnesium oxide. It is to take it out before the magnesium hydroxide is precipitated.

Q. Yes; in other words, to remove from the bittern water an impurity which otherwise would contaminate the whole product magnesium oxide?

A. I wouldn't call the sulphates an impurity in the bittern. They are more or less a constituent of the bittern.

Q. As long as it is joined together in a chemical compound the magnesium sulphates, or the sulphate is an impurity or it would be an impurity in making magnesium oxide; isn't that correct?

A. In the bittern, itself, the sulphates is not combined with the magnesium. They are both a number of ions.

Q. To separate this sulphate, however, from the bittern water so you have in the bittern water magnesium without the contamination of sulphate, you use calcium chloride, do you not, to effect a precipitation of the sulphates? A. Yes.

Q. That step is absolutely essential to purify the magnesium free from any sulphates in one of the steps to make magnesium oxide?

A. It is necessary in order to precipitate the magnesium without co-precipitating the sulphate.

Q. Now, Mr. Melhase, it is a fact, isn't it, that when this bittern water is added to calcium chloride

(Testimony of Fred Melhase.)

that causes the precipitation in your precipitating tanks? A. That is correct.

Q. This matter that precipitates out in the form of crystals or solid matter in the mixing tank is calcium sulphate, isn't it?

A. It is gypsum.

Q. Well, isn't it calcium sulphate?

A. It is $\text{CaSO}_4 \cdot 2\text{H}_2\text{O}$, which is gypsum.

Q. Is it calcium sulphate with 2 molecules of water? A. That is correct.

Q. That is the precipitated matter that occurs in your vats after the addition of the calcium chloride to remove or separate the sulphates out of the bittern? A. Yes.

Q. When you are not running this fluid to the bromine towers the very first step is to cause that precipitation of the sulphates in the bittern, isn't it? A. Correct.

Q. The reason of that is so you can separate the sulphates away from the bittern water?

A. That is correct.

Q. Unless you do that you can't continue the process and manufacture the end product, magnesium oxide, can you? [794]

A. It could be done in another manner by causing magnesium sulphate to precipitate.

Q. Well, it wouldn't be as feasible or economical as the method you pursue down at your Newark plant, would it? A. It would not.

Q. Now, again assuming this calcium sulphate, or, as you call it, gypsum, is dumped out and not

(Testimony of Fred Melhase.)

used at all, the next step—I will go back. Strike that question.

To remove the calcium sulphate, or the gypsum, you have in these large tanks in your assembly line or your plant line, you have a filtering process, do you not?

A. After most of the separation occurs, yes.

Q. And this calcium sulphate or the gypsum in these crystals or floating forms adhere to this so-called filter cloth of your filter, that is the way it is taken out of the bittern?

A. That is correct.

Q. After it is taken out of the bittern you have left in the bittern magnesium chloride, don't you?

A. I might go back and say that in that separation most of that separation of the gypsum from the magnesium chloride occurs in Dorr thickener tanks under which flow the concentrated solids from those tanks that you filter.

Q. That is one of the steps along the line of the manufacture of magnesium oxide?

A. What step is that? [795]

Q. The step you have just mentioned, the tank, you call that where the solids are filtered out?

A. It might be considered as such.

Q. Well. isn't it such?

A. The gypsum is separated from the magnesium chloride in that step, yes.

Q. Whether you use the gypsum or throw it out, it is separated at that step; that is correct, isn't it?

A. That's right.

(Testimony of Fred Melhase.)

Q. Then this bittern water goes on to the next step of processing in which after the calcium sulphate or the gypsum is filtered out you have left in the bittern, at least, magnesium chloride in solution?

A. That is correct.

Q. To get magnesium hydroxide, which is one of the steps, the next step in the process, you have to use calcium hydroxide, don't you?

A. It does not have to be limited to calcium hydroxide.

Q. Well, don't you add calcium hydroxide in your operation?

A. We don't add calcium hydroxide. We use quicklime or dolomite.

Q. That is the equivalent of that calcium hydroxide, isn't it?

A. I would consider it, yes, as far as precipitation of other magnesia.

Q. You have used other forms of calcium hydroxide, have you?

A. No.

Q. You have used dolomite?

A. And quicklime. [796]

Q. The purpose of adding that in your next step in the manufacture of magnesium oxide is to separate the magnesium from the chloride, isn't it?

A. It is to precipitate the magnesium as a magnesium hydroxide.

Q. In other words, the magnesium, after the addition of the dolomite or the equivalent of calcium hydroxide combines with hydroxide to form magnesium hydroxide, doesn't it?

(Testimony of Fred Melhase.)

A. We add lime or dolomite to this magnesium chloride combination which precipitates magnesium hydroxide and forms a calcium chloride bittern.

Q. In other words, it forms this new combination of magnesium hydroxide? A. Right.

Q. That is formed in a nature of precipitation, isn't it? A. Correct.

Q. It is from that magnesium hydroxide that you manufacture the magnesium chloride, isn't it?

A. After it has been separated from the calcium chloride, washed and purified, then it is conducted by heat into magnesium oxide.

Q. This residual of calcium chloride that is left in the bittern water is taken out and used again in the process as before, isn't it?

A. Yes, that calcium chloride that is separated from the magnesium hydroxide goes back to the gypsum department and is reacted [797] there with an acidified raw bittern to precipitate gypsum.

Q. Please consider we are not making any gypsum at all. We are making, according to your process down there, magnesium oxide. If that gypsum is saved or manufactured into usable gypsum this whole process that you have described here would all be a process in the magnesium plant, wouldn't it?

Mr. Rosenberg: Well, your Honor——

Mr. Bennett: The point is, they apparently have put emphasis on the fact that it goes to the gypsum plant. I want to show, your Honor, that is a misnomer, saying it goes to the gypsum plant. The

(Testimony of Fred Melhase.)

witness has already described now a process of manufacture where he has admitted to manufacturing magnesium oxide, your Honor, and they take this gypsum out of the product. What I want to show, your Honor, is the witness' testimony about the interjection of the word "gypsum" is misleading and a misnomer.

The Court: Tell me, are you familiar with the chart? A. I have looked it over, yes.

Q. Having in mind your familiarity with the plant, now, go down to that chart and indicate to me in your own way the beginning of the bittern and going to magnesium sulphate and trace that bittern through the various operations here for me. Do you understand my question?

A. I think that I do. I think you want me to describe the process that I outlined previously in my testimony. [798]

Q. Yes.

A. Using the chart.

Q. Yes. It may help me.

Mr. Bennett: No, I have no objection to that, your Honor. All I want is to clear up the fact that this gypsum had to be removed from the bittern in order to make magnesium oxide.

Mr. Rosenberg: Of course, the gypsum is not in the bittern.

Mr. Bennett: Well, it is partly in the bittern, part of it is added; that which is added is added to effect removing the sulphate from the bittern in order to make magnesium oxide, just as you have

(Testimony of Fred Melhase.)

to take the pit from a peach in order to can the peaches, if you can sliced peaches.

The Court: For the moment, don't pay any attention to these attorneys in their arguments. In other words, from that chart trace the various steps.

The Witness: The bittern, as we receive it from the Leslie Salt Company, it contains both magnesium chloride and magnesium sulphate.

The Court: Just a minute. Now, start again.

A. The first step in the process is to take out the bromine. The second step is to remove the sulphates from the bittern. You understand that the magnesium and chlorides and sulphates are all present as ions in the bittern. There is no chemical combination that can be assumed to be magnesium sulphates and magnesium chlorides and so on. The next step after the [799] bromine is removed is to take out the sulphates from the bittern. There we take out the maximum quantity of sulphates; because gypsum is one of our products, we want to get as much of it as we can.

Mr. Bennett: Does your Honor want to leave that in there; otherwise I move to strike out the argument.

The Court: That part may go out. Proceed.

The Witness: The sulphates are taken out of this bittern by means of calcium chloride, which precipitates these sulphates as gypsum. Then it leaves in solution magnesium ions and chloride ions, which we call magnesium chloride, and part of

(Testimony of Fred Melhase.)

that magnesium chloride bittern is then thrown away because we have no use for it. The remainder of it goes to the magnesium department, and is treated with lime or dolomite, that is here (indicating), and that forms a precipitation to magnesium hydroxide, which also results in the formation of what we call calcium chloride, the bittern which is brought back and added to the incoming raw bittern to precipitate sulphates from it. Does that help?

The Court: Yes; let us proceed.

Q. (Mr. Bennett): In this process at what time is the sulphuric acid added to the bittern?

A. As I stated before, the sulphuric acid is added when the bittern is pumped from the large storage ponds into the concrete feed ponds.

Q. That is before there is any attempt made by the addition [800] of calcium chloride to extract the sulphates?

A. It is prior to that and also prior to any attempt to extract bromines.

Q. When you are not manufacturing bromine products this bittern does not go to the bromine towers at all, does it? A. No.

Q. It goes into the line of these pipes, and tanks, and pumps and the filter?

A. It is pumped directly from the feed pond to the gypsum department.

Q. What do you define as the gypsum department, Mr. Melhase?

A. Well, all the precipitating tanks, the settling tanks, the pumps, filter, washing and drying equipment and the warehouse, so on.

(Testimony of Fred Melhase.)

Q. Leaving out any equipment that is used to dry or grind or deliver the gypsum after it is precipitated and filtered out of the bittern, what do you call the gypsum plant?

A. After it is filtered out of——

Q. Leaving aside, forgetting such facilities as you have over there for drying and grinding and delivering the gypsum after it is filtered out, what do you consider, what do you include in this statement “Gypsum plant”?

A. Well, I would consider the precipitating tanks, the Dorr thickener tanks, the pumps that pump it up to the filter, as all part of the gypsum plant. [801]

Q. If you are not grinding or drying gypsum, if you are pumping this calcium sulphate or the gypsum that is filtered out into the bay all of these pumps and tanks, filter and all, would be necessary, would they not, according to your system of manufacturing magnesium oxide for the manufacture of that particular product, magnesium oxide, wouldn't it?

A. Precipitating tanks would be necessary.

Q. In fact, all the things you say that constitute the gypsum plant, except the facilities for drying and grinding and delivering the gypsum would all be essential in the manufacture of the magnesium oxide, wouldn't they? A. Yes.

Q. So in that sense this bittern goes, when it does not come over to the bromine tank, bromine towers, to the first step of the magnesium plant?

(Testimony of Fred Melhase.)

A. I would say it goes to the gypsum plant.

The Court: What do you mean by that?

A. I consider the next step in our operation as the gypsum plant or the gypsum department that I just outlined; the precipitation tanks from a chemist's point of view, would be a part of that department.

Mr. Bennett: You recall, do you not, I believe for the first two weeks in September, 1946, when you pumped all this gypsum out into the bay and did not save any of it or dry any of it or deliver any of it—— [802]

A. No, I don't recall that we did that. To my knowledge, the first time that we ever pumped gypsum out into the flat or waste pile is when it has been necessary to shut down some of the drying equipment or filtration equipment, for repairs.

Q. In other words, when any of this drying or grinding equipment that is used to treat this calcium sulphate or the gypsum that is filtered out of the bittern would not permit processing of this gypsum by drying and grinding you then pump it out into the bay, is that right?

A. No, we don't pump it into the bay. It is pumped into a flat where it is stored.

Q. You heard Mr. Flick's testimony where Mr. Williams told him that during, or Mr. Wallace told him that during the first two weeks in September, 1946, they were pumping this slurry out into the bay?

Mr. Rosenberg: I don't think he said that. If I understood Mr. Flick, Mr. Wallace told him they

(Testimony of Fred Melhase.)

were going to do that. I don't think he ever testified that Williams told him they were doing that.

Mr. Bennett: He testified Mr. Williams said they were at that time pumping this slurry actually.

The Court: Well, were you there during the period?

The Witness: Yes, I was there.

The Court: What was the fact? [803]

The Witness: To my knowledge none of the gypsum was pumped out into the bay or even into the flat at that time.

Q. (Mr. Bennett): Even when you pumped it up into the flat this process goes right on as far as the pumping of the bittern from the storage tank into the settling tank and the filtering tank and so forth, in the process of manufacturing the end product, magnesium oxide; is that not a fact?

A. When anything happens to that drying or filtering, drying or grinding equipment and it becomes necessary to pump it out into the flat, that is done in order to keep from shutting the entire plant down.

Q. Yes.

A. Which would be a very expensive process. As a matter of fact, that washing, drying, and grinding equipment would only be down for a short period of time.

The Court: We will take a recess.

(Recess.) [804]

Q. (Mr. Bennett): You mentioned your plant at Chula Vista. Is bittern the basic raw material

(Testimony of Fred Melhase.)

from which you manufacture magnesium chloride at that plant? A. It is.

Q. The same type of operation?

A. The same type of operation.

Q. You do not have any bromine towers down there?

A. We have bromine towers there, yes.

Q. The first step is to pump the bittern into the bromine towers after you have added sulphuric acid?

A. When the bromine towers are operating, yes, that is correct.

Q. So when this bittern comes in from your storage ponds, you add the sulphuric acid and then it goes into the bromine towers, is that right? The bittern goes on to the bromine towers?

A. Will you read that question?

(Question read.)

A. That is right.

Q. What happens both at Chula Vista and also at the plant at Newark, is that correct?

A. That is right.

Q. The purpose of this sulphuric acid is to reduce the alkalinity of the bittern water?

A. It is to neutralize that alkalinity and make the bittern slightly acid.

Q. When the bromine towers are operating, the sulphuric acid [805] remains in the solution, does it not, after the bromine is extracted?

A. Yes, it is still there.

Q. Ever since you started operation down at

(Testimony of Fred Melhase.)

Newark of this new plant, you have used sulphuric acid continuously, have you?

A. I believe so. As far as I know, it has been used all the time.

Q. Are you the one down at the plant who has charge of the actual operation or is that in charge of some other individual?

A. That comes under the plant superintendent.

Q. Mr. Wallace?

A. No, the direct operation comes under Mr. Bradley, who is the plant superintendent.

Q. As far as you know, this sulphuric acid has been used in the initial steps of this processing from the time this enlarged plant started operation in 1937?

A. It has been used ever since I have been at the plant, since 1933.

Q. That is what I was coming to. You have always used the sulphuric acid both in the earlier operation prior to the building of this large plant, and since then?

A. Yes. It was used primarily to increase the chlorine efficiency in the bromine towers.

Q. You spoke about a test that you made this past October. Why did you make that test, Mr. Melhase? [806]

A. As I said before, to make certain that our previous conclusions regarding the function of the sulphuric acid were correct.

Q. Was that the first test that you had made concerning that?

(Testimony of Fred Melhase.)

A. I believe that it was, yes.

Q. And that test was for the purpose of this lawsuit, wasn't it? A. Not necessarily.

Q. It was long after this lawsuit was brought?

The Court: His answer was, "Not necessarily."
The question and answer may stand.

Q. (Mr. Bennett): Had you made any previous laboratory or other test to determine the effect of sulphuric acid in the manufacture of magnesium oxide or gypsum?

A. We had not made any test as such, but in our operations, when the bromine plants are operating we add lime to that exit bittern from the bromine plant to partially neutralize it, because we found that too much acid in that bittern is harmful, too, from the standpoint of precipitating the sulphate and on occasions we have added too much lime to the bittern and it made it alkaline. And we have also run into difficulty with our gypsum operation under such circumstances. This test was merely to verify the previous indications that we had in that regard.

Q. When you had bittern that was alkaline that caused you [807] trouble in your precipitation, just what trouble was that? Do you mean it made more difficult the precipitation of the gypsum out of the bittern water?

A. It made subsequent filtration, washing and drying of that gypsum difficult.

Q. It also made difficult the removal of the gypsum from the bittern water, didn't it?

(Testimony of Fred Melhase.)

A. No. I would say no.

Q. It made difficult the filtration of the gypsum out of the bittern, didn't it?

A. Yes, it made filtration difficult but it did not affect the precipitation.

Q. Filtration of the gypsum is an essential step in making the magnesium oxide, isn't it?

A. No, it is not.

Q. You have to filter the gypsum or remove the gypsum out of the bittern to manufacture the magnesium oxide, don't you?

A. The gypsum, as I stated before, is settled out of the bittern in this Dorr thickener tank and we waste a good portion of the magnesium chloride bittern, so it is not necessary to filter that gypsum unless we are going ahead and make specification gypsum out of it.

Q. How are you going to get the gypsum out of the bittern water so that you can go on making the magnesium oxide if you do not filter it? [808]

A. We allow it to settle in the Dorr thickener tanks and pump it out of those tanks as a slurry.

Q. What do you mean by a slurry?

A. A heavy suspension of solids in the bittern.

Q. Without filtration you still have traces, is not considerable substance, of the gypsum in the bittern solution, don't you?

A. No, most of the bittern, the magnesium chloride bittern that we use in the magnesia process does not go through a filter at all. It is merely decanted off the top of one of these tanks.

(Testimony of Fred Melhase.)

Q. Oh, you mean these magnesium chloride that you continue on into the next step, adding dolomite or lime or this calcium hydroxide, is pumped off before the filtering operation to secure the gypsum occurs?

A. It is decanted off the gypsum slurry prior to the filtration of that slurry.

Q. (The Court): Slurry—I do not quite follow that.

A. Slurry is a heavy concentration of solids in a liquid, in this case bittern.

Q. As sediment?

A. Sediment, settled solids.

Mr. Bennett: I do not know that I have that quite clear and I do not know that the Court has, either.

Q. Can you describe in a little more detail that phase of the [809] operation of those tanks that you speak of?

A. All right. After the raw bittern, the acidified raw bittern or debrominated bittern is brought back there in what we call pachuca tanks, which are reaction tanks, after raw bittern or debrominated bittern is brought together in those tanks with calcium chloride, it forms a light slurry or suspension of gypsum in this magnesium chloride bittern.

Q. Yes?

A. That slurry is run out into Dorr thickener tanks or settling tanks. The overflow from those tanks is magnesium chloride bittern, a portion of which is wasted and a portion of which goes to the

(Testimony of Fred Melhase.)

magnesia plant for the precipitation of magnesium hydroxide. The underflow from those tanks contains a small portion of the bittern, which is taken out by a filter if the gypsum is processed.

Q. What is done to the bittern that is taken out of the filter?

A. Right now it is being thrown away because we do not need that bittern, as I stated before. We need only about half of the magnesium chloride bittern that we produce.

Q. What did you do with it before? You say right now. What did you do with it at a previous time?

A. At one time, when we were producing the maximum quantity of magnesia that it was possible to produce from these bitters, it was saved.

Q. It was saved for further processing by the addition of [810] dolomite or lime or calcium hydroxide, is that right?

A. That is quite right.

Q. For the processing of magnesium oxide?

A. But now we do not require all that bittern for the magnesium oxide plant and it is thrown away.

Q. When were you last producing this so-called maximum amount when you used all this bittern after the gypsum was taken out for the manufacture of magnesium oxide?

A. Oh, that was prior to 1943 some time, I believe, when our bittern supply was quite low.

Q. As a matter of fact, during the war period up to 1945, you were still endeavoring to produce

(Testimony of Fred Melhase.)

the maximum amount of magnesium oxide that your plant was capable of making, weren't you?

A. That is correct.

Q. So you were not throwing away any of these magnesium chloride during that period of time, were you?

A. Yes, we were still throwing away magnesium chloride because there were other limitations to our plant, other than the amount of magnesium chloride that was available.

Q. Do you have any production records down there or would you know about that, showing month by month or weekly operations as to the amount of bittern that is purchased and used and the amount of chemicals that are purchased and used and the operation reports of this process?

A. I presume that there are such reports. We use all the [811] bittern that is available to us for the precipitation of gypsum. All of the bittern that we receive from the salt company is used for that purpose.

Q. You said that before. I am asking you about these operational reports. You do not keep such reports, do you?

A. I do not keep such reports, no.

Q. Who would keep those reports?

A. If anyone has them, I imagine it would be the plant superintendent, the records of the amount of magnesium chloride thrown away.

Q. Would Mr. Watt have such records?

A. I do not know.

(Testimony of Fred Melhase.)

Q. You heard the statement of counsel for your company that prior to 1946 no part of the sulphuric acid was charged against gypsum production, didn't you?

Mr. Rosenberg: That is not what I said, Mr. Bennett. It was some time in 1945 when the bromine towers were shut down.

Mr. Bennett: Yes. I stand corrected as to the date.

Q. (The Court): Do you know anything about that?

A. Could I have that question over again?

(Question read.)

A. I do not know whether that remark has been made before or not. I guess it has.

Q. (Mr. Bennett): Did you know that that was the fact?

A. I do not know how the records have been kept, so far as the [812] charges are concerned.

Q. Assuming it was a fact, do you know why there was no charge for sulphuric acid made against gypsum up until that time?

Mr. Rosenberg: If the Court please, I put this man on as a chemist and not as an accountant, and I submit that that is not proper cross-examination and it is beyond the scope of the direct examination. He is going into accounting now.

The Court: The objection is sustained.

Mr. Bennett: I did not intend that. I do not want to take time arguing, but this witness has testified to other things than chemistry. He has

(Testimony of Fred Melhase.)

outlined the detail there and he has testified on direct examination as to why the sulphuric acid was necessary in gypsum.

The Court: The Court has ruled.

Mr. Bennett: Thank you, Your Honor.

Q. The addition of sulphuric acid to bittern water has always been used by the company from the very start of your connection with it back in the early 30's, hasn't it? A. Yes.

Q. Where the bittern in solution is alkaline, it does affect the precipitation and crystallization of the gypsum or calcium sulphate in the bittern solution, does it not?

A. It would not affect the actual precipitation. It would affect the shape and size of the crystals, which would in turn affect its filtration, washing and drying. [813]

Q. I direct your attention to your company's answer to the 20th interrogatory proposed by the plaintiff, in which the following appears:

"Answer: Interrogatory 20. Defendant states that sulphuric acid was necessary in the production of gypsum because the pH of bittern is too high to permit the proper precipitation of gypsum from the bittern and this sulphuric acid is added to the bittern to lower the pH to a point where the separation of the gypsum from the bittern is possible."

Do you agree with that statement?

A. I do not agree with it the way it is stated. They mean there that sulphuric acid is necessary to precipitate the gypsum in a form in which it can

(Testimony of Fred Melhase.)

be handled later on in this filtering, washing and drying operation.

Q. You did not prepare or having anything to do, then, with preparing this answer to plaintiff's interrogatory 20 that I have just read?

A. I do not believe so.

Q. I read further from the answer to the interrogatory:

“A large portion of the sulphuric acid added is incorporated in gypsum produced because the sulphate ions in the sulphuric acid precipitate with the calcium ions in the bittern to produce gypsum aggregating approximately one-half of 1 per cent of the total gypsum produced. In other words, sulphuric acid serves a double function: one, of controlling the [814] basicity of the solution and, two, of actually adding weight for weight to the gypsum produced.”

Do you agree with that statement?

A. I agree to the fact that this sulphuric acid which is added to the bittern would be precipitated along with the sulphates. It would be precipitated along with the rest of the sulphates that are in the bittern, correct.

Q. Do you agree with the statement that by the addition of sulphuric acid it actually increases the production of gypsum approximately one-half of 1 per cent of the total gypsum produced?

A. I do not know what that figure would come out to be, but it would increase the quantity of gypsum that can be produced.

(Testimony of Fred Melhase.)

Q. Do you also agree that adding it to the bittern produces weight for weight to the gypsum produced? In other words, adding a pound of sulphuric acid actually produces an additional pound of gypsum?

A. It would actually produce more than a pound of gypsum.

Q. Then this statement in the defendant's answer to the interrogatory is not correct, according to your understanding?

Mr. Rosenberg: That is argumentative.

Mr. Bennett: I think it is proper cross-examination, Your Honor. Here they blow hot on the one hand and now they put on a witness who blows cold on the other. I think this is eminently proper cross-examination. [815]

The Court: Read the question.

(Question read.)

The Court: It is argumentative, but I will let him answer in the interest of time.

A. The molecular weight of sulphuric acid is around 96 or 98. Gypsum has a molecular weight of 172, I believe. So the relationship between the weight of sulphuric acid and the weight of gypsum would be 172 to 98. In other words, 172 pounds of gypsum for every 98 pounds of sulphuric acid.

Q. (Mr. Bennett): What is the value or cost of a pound of sulphuric acid, Mr. Melhase?

A. I think it is around \$18 a ton.

Q. And that would be about how much a pound? How many cents a pound?

(Testimony of Fred Melhase.)

Mr. Rosenberg: How much did you say, Mr. Bennett?

Mr. Bennett: He said \$18 a ton.

A. (The Witness): $9/10$ of a cent. I think that figures out to $9/10$ of a cent per pound.

Q. (Mr. Bennett): $9/10$ of a cent?

A. I think so.

Q. The cost of sulphuric acid per pound, then, would be approximately $9/10$ of a cent per pound, wouldn't it?

A. I think that is correct.

Mr. Bennett: On that basis, counsel, assuming the price that you have demanded currently for this gypsum, \$4.36 a ton, [816] that would approximate about $2/10$ of a cent per pound of the value of gypsum that you place upon there; that is a fact, too, isn't it?

Mr. Rosenberg: That I place upon it?

Mr. Bennett: Well, your client asks \$4.36 a ton for gypsum, and that figures out to $2/10$ of a cent per pound, doesn't it?

Mr. Rosenberg: I do not know. If you have figured it out, subject to check, I will accept it.

Q. (Mr. Bennett): Assuming you get two pounds of gypsum for every pound of sulphuric acid added, that still does not result in a profitable operation to the company, does it, Mr. Melhase?

Mr. Rosenberg: I submit that that is argumentative and it is completely unintelligible. It has no foundation in fact. We are not selling sulphuric acid; we are selling gypsum.

(Testimony of Fred Melhase.)

Mr. Bennett: I know, but you see the purpose for adding this is that it adds weight for weight to the gypsum produced.

Mr. Rosenberg: It says it serves two functions. If you want to argue with me, I will argue it out with you, but I do not think it is proper to argue with the witness. He did not say that. I prepared those answers and I confess there may be some inaccuracies in the chemical answers.

Mr. Bennett: You put this witness on to show the necessity of adding sulphuric acid for the production of gypsum. It is an important point in the case and I think I am entitled [817] to cross-examine on it.

Mr. Rosenberg: I have no objection to your cross-examining.

Mr. Bennett: And I am certainly entitled to cross-examine in relation to these interrogatories you filed in this case.

Q. What do you understand as controlling the basicity of the solution, Mr. Melhase?

A. Controlling the pH of the solution or the hydrogen ion content of that solution.

Q. In other words, to raise the acid character of the bittern from what otherwise would be an alkaline stage, is that correct?

A. That is correct, to make the bittern more acid.

Q. And the reason for that increase of acidity is to further the precipitation of the gypsum?

(Testimony of Fred Melhase.)

A. The purpose of it is to precipitate the gypsum in a form which can be handled later on.

Q. I want you to first admit that it does further the precipitation, in whatever form, of gypsum, does it?

A. I do not know what you mean by further the precipitation.

Q. I read to you, and I will read again, this answer of the defendant to our 20th interrogatory:

“The defendant states that sulphuric acid was necessary in the production of gypsum because the pH of bittern is too high to permit the proper precipitation of gypsum from the bittern, and this sulphuric acid is added to the bittern to lower the [818] pH to a point where the separation of the gypsum from the bittern is possible.”

Now, do you still agree or disagree with that statement?

A. I think from a chemical standpoint I would disagree with that statement, yes.

Q. You do not know on what source of authority your company made that statement?

A. No, I do not. [819]

Q. In 1943 you substituted dolomite as an agent to add to magnesium chloride in the bittern water after the sulphate or gypsum had been taken out in place of some other chemical product, didn't you?

A. That is correct; we substituted in 1943 dolomite for quicklime in that operation.

Q. Why was the dolomite substituted for quicklime?

(Testimony of Fred Melhase.)

A. In order to increase the capacity of the magnesia plant beyond the point of precipitation and to increase the capacity of our counter-current washing system.

Q. In other words, to produce more magnesium oxide, wasn't that it?

A. That was one of the things.

Q. When you used dolomite to any given quantity of bittern water you produced more magnesium oxide than that if you used lime. don't you?

A. That all depends on how much dolomite you use.

Q. If you used the amount of dolomite necessary to produce the magnesium hydroxide that from which magnesium oxide is produced you get a higher quantity in pounds of magnesium oxide than if you had used lime for that purpose, don't you?

A. In treating this bittern with lime or dolomite, as the case may, if you used dolomite in place of lime pound for pound more magnesium is produced.

Q. Yes. In other words, when you started to use dolomite it [820] was for the purpose of increasing the total production of magnesium oxide; isn't that correct?

A. Yes. Our plant facilities there were not such that we could produce enough lime in our plant to produce all the magnesium that we required.

Q. You also gave us another reason.

A. Also, our settling tanks were not large enough when lime was used. Magnesium hydroxide

(Testimony of Fred Melhase.)

precipitated from the dolomite has better settling and washing characteristics and filtration characteristics than a product from quicklime.

Q. And it also has a greater quantity pound for pound in relation to the end product to the amount of bittern used than would be the case of using lime? A. That's right.

The Court: What effect has this on the other products?

The Witness: What other products are you referring to?

The Court: You say it increases the volume of magnesium more than the others, this dolomite.

A. I don't believe it has any.

Mr. Rosenberg: That is added after the gypsum is taken.

The Court: I understand. I was trying to trace it. In any event he said it had none. What was the answer?

The Witness: It had no effect on the volume of gypsum.

Q. (Mr. Bennett): According to Plaintiff's Exhibit 18, which contains figures furnished by the defendant, Mr. Melhase, it appears that in the calendar year 1942, when you were using [821] lime down here where this word calcium hydroxide appears in the chart you produced 31,826 tons of gypsum, and in the next calendar year, 1943, when you used dolomite, the gypsum production went to 24,431 tons; that drop in gypsum production was due, was it not, to the substitution of the dolomite

(Testimony of Fred Melhase.)

in place of lime that previously had been used?

A. I don't know whether it was, or not. I would have to go back over our records to answer that.

Q. Can you ascertain that from your records?

A. I don't know.

Q. Well, I wish you would in the morning.

A. It may have been that we just did not have enough bittern to produce the amount of lime, the amount of gypsum in 1943 that we had in 1942; I don't know.

Q. As a matter of fact, in 1943 you produced more magnesium oxide than you produced in 1942?

A. I don't know the relative amounts that were produced.

Q. Aren't there available records that would show that to you?

A. I can perhaps find out.

Q. Well, I wish you would.

The Court: How would you find out?

A. I think I can go to our plant superintendent and get his records.

The Court: Is the plant superintendent available?

Mr. Rosenberg: He is not here, your Honor.

Q. (Mr. Bennett): Dolomite is half calcium and half magnesia, isn't it?

A. Calcined dolomite is rough calcium oxide and magnesium oxide with a molecular basis.

Q. Going back for a moment to this plant, when you first went to work at Newark they had a plant actually in operation, that was not the pilot, in addition to the pilot plant, did they not?

(Testimony of Fred Melhase.)

A. Yes, they had the bromine plant in operation at that time.

Q. They were also manufacturing magnesium products at that time, too, weren't they?

A. No, they were not.

Q. Nothing but bromine was being produced?

A. Nothing but bromine.

Q. When was the first time that any magnesium produced at Newark?

A. As far as I know, the first magnesium products that were produced at Newark were the products that came from this pilot plant that they were building when I first went there, and that must have been in late December of 1933 or January of 1934.

Q. Did that pilot plant continue thereafter to operate in the production of magnesium products?

A. Yes, it continued to operate on an experimental basis.

Q. Was that the only plant to produce those magnesium products at Newark until 1937? [823]

A. That is correct.

Q. Did you have anything to do with those magnesium products that were produced at that pilot plant?

A. Yes. I worked in the pilot plant for about a year, as I testified before, and then in the research department in which we were experimenting.

Q. What was done with those magnesium products that were produced at that time?

A. I presume they were all sent out to different

(Testimony of Fred Melhase.)

companies for valuation. I don't know what all was done with them.

The Court: Did you testify they produced about 200 pounds a day?

A. No, I did not testify to that.

The Court: What did they produce, if you know?

A. I think it was in excess of that, a ton a day, or so.

The Court: What became of those products, were they marketed?

A. I think some of them were sent out on a trial basis to determine the economical value.

Q. (Mr. Bennett): What position did Dr. Seaton, Max Y. Seaton, have in connection with those plants at that time?

A. I believe he was a technical director at that time.

Q. He was your superior, wasn't he?

A. Yes.

Q. You were operating under his general direction? [824]

A. I think there were two or three others along the line between myself and Dr. Seaton.

Q. You have seen this article by Dr. Seaton, published in 1941, entitled, "Bromine and Magnesium Compounds Drawn From Western Bays and Hills"?

A. I believe so.

Q. Published in 1931. That was published in "Chemical and Metallurgical Engineering, November, 1931."

(Testimony of Fred Melhase.)

A. Yes, I have seen reprints of it.

Q. I direct your attention to this statement at page 640, under the title "Other Salts Now Recovered.

"The present magnesium chloride market, which can logically be served from a Pacific Coast plant will absorb but a fraction of the total magnesium values present in the bittern now being received, which quantity is regularly increasing as salt consumption of the West Coast steadily grows. Accordingly, after extensive laboratory investigation and some two years' pilot operation, a small plant for recovery of these values in other forms is now in production and a large plant is being engineered."

Do you know what small plant it was that Dr. Seaton referred to that was engaged in the manufacture of magnesium chloride or magnesium products?

A. I never saw that plant, myself. I presume that it was a very small scale pilot plant, the next step in the investigation [825] of this process after some of the laboratory work had been done; in other words, it was just the bathtub stage.

The Court: In any event, you know nothing about it? A. I know nothing about it.

Q. (Mr. Bennett): This control laboratory where you work now, Mr. Melhase, is engaged in analyzing, sampling and testing products other than gypsum, is it not?

(Testimony of Fred Melhase.)

A. Yes. I am more or less a director of that laboratory.

Q. What other things does the laboratory do other than testing these samples of gypsum?

A. They test samples of magnesium oxide as well.

Q. Are there other products manufactured down there now other than the base product magnesium oxide?

A. And gypsum.

Q. And gypsum?

A. Those are the two products that are being manufactured at the present time.

Q. Are there various forms of the magnesium oxide and further refinements of that that are being produced there?

A. Yes, there are a number of different forms of magnesium oxide which we produce.

Q. That requires further and various forms of processing, does it not? A. That is correct.

Q. You are concerned with all of those various other products [826] that are being produced out of magnesium oxide, aren't you?

A. Well, they are not produced out of magnesium oxide. They are magnesium oxide of different forms which are produced.

Q. Different forms. How?

A. We have what we call S-99, S-90, which are refractory magnesium used in making bricks for open-hearth furnaces, lime kilns, and such. They are very high temperatured bricks. We make a

(Testimony of Fred Melhase.)

product called Remosil, which is used in water softening, Magnesium oxide, which we call 2661, used for chemical purposes, the manufacture of Epsom salts and so forth. A number of products what we call 2663, 2662, 64, 65, that have a variety of chemical uses.

Q. All of those products that are used as pharmaceuticals or other scientific chemical purposes require analysis and testing, do they?

A. Yes. We don't produce all of those products at one time, however.

Q. The tests that you made of the gypsum are the same tests that you made over a long period of time, are they not? A. That is correct.

Q. In other words, you want to test the gypsum content and the other requirements set forth in the contract, you have generally used the same type of test for ten or fifteen years now?

A. Yes.

Q. Have there been any new or different techniques of testing [827] used through these years?

A. Oh, may have been refinements through the years.

Q. But approximately the same procedure is followed in each batch that you examine?

A. That's right.

Q. You understand that similar tests were made by Pacific Portland Cement Company, don't you, in their laboratory?

A. I presume they do, yes.

Q. How many people work for you in that laboratory?

(Testimony of Fred Melhase.)

A. About a total of 17, including the janitor and the chemist in charge of the laboratory, and his assistant, and other chemists and technicians, about 17.

Q. The testing of the gypsum is relatively a small part of the activities of this laboratory, isn't it, in so far as the time consumed?

A. Well, I don't know whether it is a minor part, or not. It is perhaps between five and ten percent of the total work, maybe a little more.

Q. You did not keep any time record of the amount of time in the laboratory that is devoted to gypsum tests? A. Yes.

Q. You mean you have time cards showing precisely the amount of time of your laboratory man hours that were put in on gypsum testing?

A. Yes. Each one of our people in the laboratory keeps a [828] record of his time which he spends, two hours on gypsum, he puts that down, or if two hours on one of the various magnesium products that would be put down.

Q. So it is possible for you to determine at the end of any money or at the end of any year actually the man hours, a record of the actual man hours employed in testing gypsum?

A. I think that is correct. It would be a question for our accountants to answer, though.

Q. Do what?

The Court: For the accountants to answer.

The Witness: For our accountants to answer.

Mr. Bennett: Well, I thought if he knew that himself——

(Testimony of Fred Melhase.)

The Court: Well, they keep time cards.

The Witness: We keep the time cards.

Q. (Mr. Bennett): Do you keep these on a monthly or annual basis?

A. Kept on a daily basis or weekly basis. The time cards are on a weekly basis.

Q. Do you have any summary or compilation of the time for any single period of a week, or a month, or a year showing the hours of time spent on gypsum?

A. No, I don't have those records.

Q. Does anyone have those records?

A. I assume our accounting department has; I don't know.

Mr. Bennett: Well, I would like to have those records from [829] counsel, if the court please.

Mr. Rosenberg: You seem surprised at this information, Mr. Bennett: It is all set forth in our answers to the interrogatories.

The Court: Is that all of this witness?

Mr. Bennett: Well, just one second, your Honor.

Q. During this first two weeks in September, or from September 1st to September 13th, 1946, was this sulphuric acid used in the operation down at the plant at Newark, as you testified that it has been used from the beginning of the time that you first had anything to do with that plant?

A. What was this period that you referred to?

Q. September 1st to September 13th, 1946.

A. I presume that the sulphuric acid was used at that time, unless the plant was actually shut down.

(Testimony of Fred Melhase.)

Q. Do you know at any time since that plant has been manufacturing magnesium oxide or manufacturing gypsum that they have failed to use the sulphuric acid at the initial stage of operation?

A. Only in that one test in which I mentioned.

Q. That was merely a laboratory test and not the operation of the plant?

A. No, that was a plant test.

Q. When did that occur?

A. In October of this year.

Q. Just one day? [830]

A. No, there were several days, as I recall.

Q. Several days. Was any report written up of that test?

A. I don't believe there was any formal report.

Q. Did you make any report concerning it?

A. No, I did not.

Q. No record was made of the test?

A. I think there were some records kept.

Q. Did you keep a record of the test?

A. I did not——

Q. Who did?

A. (Continuing): ——keep any personal record of the test. One of my men followed the test, and I did observe the test which was primarily an observation test.

Q. But you did not make any report or memorandum of what was done and what was observed?

A. I think there are some memoranda on it. I am not positive.

Q. Have you not seen it?

(Testimony of Fred Melhase.)

A. One of my men got out a short memorandum regarding the test.

Q. Do you know where that is now?

A. I believe we have one in our files at Newark.

Q. Well, I would like to see a copy of that, please, your Honor, for the purpose of further cross-examination of the witness. But other than that test, Mr. Melhase, ever since you have been down at that plant they have always used sulphuric acid in the initial step of treating the bittern water [831] as it came from the holding pond, have they not? A. I think so, yes.

Q. And any time when gypsum was not being manufactured during that period they still continued to put in the sulphuric acid, did they not?

A. That's right. Those instances were of only a short duration, however.

Q. Well, short or long, they never stopped putting in the sulphuric acid at that first stage merely because they were not manufacturing gypsum, except on this test period in October, 1947?

A. That's right.

Mr. Bennett: Now, I think that is all we have, your Honor.

The Court: How much time do you want, Counsel?

Mr. Rosenberg: I only have a few questions.

Redirect Examination

Q. (Mr. Rosenberg): Let me ask you, Mr. Melhase, where is that sulphuric acid added?

A. That is added as the bittern is pumped into the concrete feed ponds.

(Testimony of Fred Melhase.)

Q. Then the bittern goes into the ponds?

A. Yes; it is introduced into the feed system as it flows into the feed ponds.

Q. When the bittern is drawn off to go to the gypsum department, it is drawn from what source?

A. From those concrete feed ponds.

Q. I may have asked you before, but I am not sure, will you state whether or not it is necessary to make gypsum in order to make magnesium oxide?

A. It is not necessary to make gypsum, no. It is necessary to take the sulphate out only.

Mr. Bennett: Wait a minute. May I have that answer read?

(The answer was read by the reporter.)

Q. (Mr. Bennett): What is the difference?

Mr. Rosenberg: Well, you ask the witness.

Mr. Bennett: I beg your pardon.

Q. (Mr. Rosenberg): Mr. Melhase, is there gypsum in the bittern?

A. No, there is no gypsum in bittern.

Q. Gypsum is not contained in the bittern as it comes into the plant?

A. No, not as such.

Q. Assume that you would discontinue for one reason or another the making of magnesium oxide at the plant, would it be necessary for the production of gypsum to have these mixing tanks and precipitation tanks and the other equipment that you mentioned as being utilized in the production of gypsum?

(Testimony of Fred Melhase.)

Mr. Bennett: I don't know that the proper foundation has been laid for that.

The Court: I will allow the question. [833]

The Witness: Yes; all that equipment would be necessary even though magnesium was not produced.

Q. (Mr. Rosenberg): Assuming you would continue to produce gypsum. A. That's right.

Q. Has there been any time during the period that you were employed at this plant prior to the time, prior to 1945, that they were not producing discontinued, was there any period prior to that time, prior to 1945, that they were not producing bromine at the plant?

A. No, not that I recall; at no time prior to 1945 did they discontinue the production of bromine.

Q. Let me ask you this: If you were going to discard the gypsum when it is precipitated out of the bittern and not processed, draw it off and filter it and dry it and grind it, would you require the filter?

A. No, you would not require the filter.

Q. With reference to the use of dolomite, in 1943 did you continue using dolomite, or was it used for some period of time, limited time in 1943; do you know?

A. The use of 100 percent dolomite was limited for a few months in 1943 and a few months in 1944. After that time, however, we went back to a mixture of lime and dolomite.

(Testimony of Fred Melhase.)

Q. So for the period of time in 1943 that you did use——

A. I think it was from about July or August of 1943 through January or February, 1944. [834]

Q. With reference to keeping records of time spent in the laboratory in connection with the various products, does that apply to yourself and the laboratory superintendent as well or only as to the technicians who work in the laboratory?

A. Primarily to the technicians who work in the laboratory. I do not make a breakdown of that sort myself.

Q. How about the laboratory superintendent? Do you know if he does?

A. I do not believe that he does, no.

Mr. Rosenberg: That is all.

Recross-Examination

Q. (Mr. Bennett): If you stopped this laboratory control work in your laboratory, it would be necessary to continue the laboratory just as you have it set up now, would it now, Mr. Melhase?

A. It would not be necessary to have as many people in the laboratory as we have now, no.

Q. You said that approximately 5 per cent of the total time of that laboratory was taken up——

A. I do not know what the exact percentage is. I think I said between 5 and 10 per cent or maybe a little more.

Q. I am going to read to you the answer of the defendant to interrogatory 10G:

(Testimony of Fred Melhase.)

“Indirect charges shown on Exhibit F would have been incurred if no gypsum had been produced but in less and unascertainable [835] amounts.”

Assuming that the laboratory control is one of the indirect charges shown on Exhibit F, do you agree with that statement, that if no gypsum had been produced, these laboratory charges would have been incurred but in a lesser and unascertainable amount?

A. Well, direct labor would have been ascertainable. Whether the laboratory superintendent's time would have been ascertainable, I do not know. That is something for the accountants to figure out, I think.

Q. Do you have any single laboratory technician who works solely on this gypsum?

A. Not solely on the gypsum, but when he does work on the gypsum he does put down his time.

Q. Prior to 1943, did you ever use any dolomite in this process or manufacture down at Newark?

A. We may have used a little bit in 1942. I am not certain. I think we had used anywhere from 10 to 25 per cent in 1942.

Q. In this method of testing, according to your understanding, these batches by weekly composites according to the standards of the American Society for Testing Materials?

Mr. Rosenberg: Are you talking about the samples now or the methods of testing?

Mr. Bennett: The samples he has already testified to.

(Testimony of Fred Melhase.)

The Witness: I do not think it says in those methods by [836] the American Society of Testing Materials, how frequently you should test a product.

Q. (Mr. Bennett): The principle is to test each batch of product to determine whether each batch is according to standard, isn't it?

A. Yes, but we do not make the gypsum in batches. It is a continuous process.

Q. And your method is simply to take samples weekly and make——

The Court: Daily and weekly.

The Witness: We take them daily.

Q. (Mr. Bennett): And then the composite of these samples and test the composite, is that correct?

A. We do not actually test the composite. We test the 8-hour samples, the shift samples, but we do not perform any analysis on the composites.

Q. Do you ever advise Pacific of the results of your 8-hour samples?

Mr. Rosenberg: Just a moment. To which I will object on the ground it is incompetent, irrelevant and immaterial.

The Court: The objection is sustained. Now we will adjourn. My patience is exhausted, gentlemen.

Mr. Bennett: I am sorry.

The Court: We will adjourn until 10:00 o'clock tomorrow morning.

(Thereupon an adjournment was taken until tomorrow, Wednesday, December 24, 1947, at 10:00 o'clock a.m.) [837]

Wednesday, December 24, 1947, 10:00 o'clock a.m.

The Court: Pacific Portland Cement Company v. Westvaco.

Mr. Rosenberg: Shall we continue with Mr. Melhase or do you wish to recall Mr. Barrows for cross-examination, Mr. Bennett?

Mr. Bennett: Whichever the Court would prefer.

The Court: Didn't we get through with him?

Mr. Rosenberg: I do not believe so. You will remember Mr. Barrows was to return this morning for further cross-examination and I believe that Mr. Bennett was in the process of cross-examining Mr. Melhase.

The Court: Didn't we get through with the last witness on the stand?

Mr. Bennett: There are two or three questions, Your Honor.

The Court: Call him.

FRED MELHASE

was recalled as a witness on behalf of the defendant, and having been previously duly sworn, testified as follows:

Cross-Examination (Continued)

Q. (Mr. Bennett): Mr. Melhase, one matter that I would like to clear up: You said at this stage, or the lower part of the chart, Plaintiff's Exhibit 16 for identification, you added either quicklime or dolomite instead of calcium hydroxide. Do [838] you recall that? A. That is correct.

(Testimony of Fred Melhase.)

Q. As a matter of fact, quicklime when added in solution, becomes calcium hydroxide, does it not? When you add quicklime with water, it forms calcium hydroxide, doesn't it?

A. In this case I do not know whether the quicklime goes first to calcium hydroxide and then to magnesium hydroxide or whether the reaction takes place directly from the calcium oxide to magnesium hydroxide. That is a very fine point.

Q. But as an ordinary matter of chemistry, the addition of water to quicklime forms calcium hydroxide, doesn't it? A. That is right.

Q. You just do not know what the reaction is here?

A. You would get an entirely different type of precipitate, however, if you added hydrated lime to this bittern than you do when you add quicklime or dolomite to it.

Q. When you add calcium chloride to the bittern water, it forms this precipitation of the calcium sulphate or gypsum, part of that settles to the bottom and some of it still remains in suspension, does it not, in the settling tank?

A. Very little remains in suspension.

Q. Well, some still remains? It does not all go flat to the bottom and form there in a solid mass, does it?

A. Oh, I would say 99-plus per cent of it goes right to the bottom, yes. There is a little very fine suspended matter in [839] the bittern, in the magnesium chloride there.

(Testimony of Fred Melhase.)

Q. Through the fluid into the settling tank?

A. Yes, when the magnesium chloride bittern overflows the settling tank.

Q. I asked you yesterday in the period of September 1 to September 13, 1946, whether any gypsum had been produced or any gypsum analyzed in production. You said you did not know. Have you since investigated and determined from your laboratory records or any other records or any other source of information as to whether gypsum was actually produced and samples tested, daily samples, 8-hr. samples during that period of time?

A. I have not had a chance to get back to the plant and check any records since I was here yesterday.

Q. You have made no attempt to do that either by telephone or otherwise? A. No.

Q. Would your records show whether there was any calcium sulphate or, rather, gypsum produced during that period September 1 to September 13, 1946; also whether there were any samples tested or analyzed in your laboratory during that period?

A. I think the plant records and laboratory records would show that.

Mr. Bennett: I presume, counsel, there is no need of a formal demand at this time to have the records for that period of time produced? I suppose you can supply them at a later [840] convenient time. I would ordinarily like to preserve further cross-examination of the witness until they

(Testimony of Fred Melhase.)

are produced, but I won't press the matter at this time.

Q. Do you know, so far as this bittern water that comes in, the nature of the contract or the arrangements you have with the Leslie Salt Company to obtain that bittern? A. No, I do not.

Q. Your company has, does it not, an agreement whereby you take all the bittern produced by the Leslie Salt Company?

A. I do not know exactly what that agreement is.

Q. As I understand it now, you have down there being furnished to you more bittern than you need in your overall operation, isn't that a fact?

A. No, I would not say that is true. I believe I stated yesterday that we have more magnesia values in the bittern than we need. However, we do process all the bittern and make gypsum, all the gypsum that we can. Every batch of bittern goes through our plant and gypsum is produced from it.

Q. But up to recent date you were endeavoring to produce down at your plant all the magnesia products that you could produce, weren't you?

A. Oh, we probably were producing back in 1941 or thereabouts—I guess we were using all the magnesium values in the bittern.

Q. I am asking now if it is not a fact that up to and including 1945 you were endeavoring to produce all the magnesia that [841] your plant had a capacity to produce.

A. Well, I do not think that we were using all the magnesia in the bittern at that time.

(Testimony of Fred Melhase.)

Q. That was not the question. You were endeavoring, were you not, in your operation down at the plant there to turn out, produce all the magnesia products that the plant was capable of producing, at least up to and including 1945?

A. I would not say that that was so. It depends on our sale of magnesia. I do not know exactly what that is.

Q. Oh, your degree of production, then, depends upon your sales outlets at the particular time, is that so? A. Partly, I presume.

Q. You knew that during the wartime there was an unlimited demand for magnesia products and that the War Department was asking you folks to step up your production, don't you?

A. Certain products, yes.

Q. And that was one of the reasons why you started using dolomite to increase your magnesia output, wasn't it?

A. We did increase it, but whether we increased it to the maximum capacity of the plant I am not in a position to say.

Q. You just don't know. That is all.

Redirect Examination

By Mr. Rosenberg:

Q. Mr. Melhase, do you know this: In the year 1943 did the Westvaco plant at Newark process all the bittern that it obtained from the Leslie Salt Company? [842]

A. We have always processed all the bittern that

(Testimony of Fred Melhase.)

we could obtain from the Leslie Salt Company, yes.

Mr. Rosenberg: That is all.

Mr. Bennett: One moment, and then I will be through.

Recross-Examination

By Mr. Bennett:

Q. How long were you associated with Mr. Stanley Barrows when he was president of the California Chemical Corporation?

A. Oh, I believe I have known Mr. Barrows since about the time I went to work for the company in 1933.

Q. And you had frequent contacts down there with him at that time?

A. No, I would not say that I had frequent contacts.

Q. He was in charge of the whole management of the California Chemical Corporation, however, was he not? A. He was president of it.

Q. I am going to direct your attention to a statement that Mr. Barrows made in his deposition on October 25, 1947, reading at the bottom of page 31, line 20:

“Q. Are you familiar with the chemical process involved in the making of these products: magnesium oxide, and bromine, and ethylene-dibromide and gypsum?

“A. Not the chemical processes; just in a general way.

“Q. And do you know whether sulphuric acid is used in the manufacture of those products? [843]

(Testimony of Fred Melhase.)

“A. Yes, I know we buy lots of it; we have for years bought sulphuric acid.

“Q. And that sulphuric acid is necessary in the process of manufacturing these products, such as magnesium oxide and bromine?

“A. Yes, and on the gypsum also; it is used in the whole process.”

Do you agree with that statement by Mr. Barrows?

A. No, I do not believe that I do from a technical standpoint.

Q. One other question and then I am through. You stated yesterday you were now furnishing a composite weekly sample of the gypsum to Pacific State, please, how long that has been carried out, that is, how long have you been furnishing a weekly sample?

A. I do not actually recall. For the last year or two, I think.

Q. Prior to that what sort of samples did you furnish?

A. I do not know whether they were daily samples or car samples or just exactly what they were.

Q. They were car samples, weren't they, Mr. Melhase?

A. I can't say definitely. I have never paid an awful lot of attention to the samples that were furnished Pacific Portland.

Q. You just do not remember that?

A. Merely what they requested, I presume.

(Testimony of Fred Melhase.)

Q. That was a minor part of your responsibilities? [844] A. That is right.

Q. And you just did not pay much attention to that, is that correct? A. That is correct.

Q. This plan that you now have of taking and furnishing a composite weekly sample of your week's production is something that has just been started by the company in the last year, isn't it?

A. I couldn't say how long that has been going on.

Q. You said a while ago——

A. Recently, yes, the last year or two.

Mr. Bennett: That is all.

The Court: Step down.

STANLEY H. BARROWS

called as a witness on behalf of the defendant, and having been previously duly sworn, testified as follows:

Cross-Examination (Continued)

By Mr. Bennett:

Q. Mr. Barrows, yesterday in your testimony you stated that after you had submitted to Mr. Colton your letter of September 18, 1936, and the enclosed draft of the proposed agreement, that several discussions were had, and you said one phase of this discussion was with reference to the cancellation clause. You recall when your deposition was taken on October 25, 1947, don't you? [845]

A. Yes.

(Testimony of Stanley H. Barrows.)

Q. At that time you were asked, were you not, to relate the conversations you had had with Mr. Colton with reference to this matter of prices and costs? Do you recall that?

A. In a general way, yes.

Q. You also recall that in your deposition in that connection you did not say anything about any discussion having to do with the cancelation clause, did you?

A. I do not recall. I think the deposition would show that.

Q. I am going to ask you to read, Mr. Barrows, beginning at page 24, line 2, down to and including all of page 24 and 25.

A. This part about the loss of those memorandum papers is as far as you want me to go on 26?

Q. No, I only wanted you to read 24 and 25.

A. I have read 24 and 25.

Q. I will ask you whether this testimony was not given on your deposition, questions asked and answers given:

“Q. Well, at that time”—you were referring back to June 5 and September 18, 1936—“you were proposing that any increase in price by reason of any increase in cost should be limited to those increases in direct costs such as labor, supplies and/or materials and fuel? Wasn’t that so?”

“A. I wouldn’t think so, Gene. It is a starting point.

“Q. Well, did you have——

(Testimony of Stanley H. Barrows.)

“A. And I know we had a lot of talks on that afterward. [846]

“Q. Well, did you have any—withdraw that.

What talks did you have afterward, and with whom, concerning that?

“A. Mr. Colton and myself talked on numerous occasions.

“Q. You mean after——

“A. After this preliminary draft.

“Q. Of September 18th? A. Yes.

“Q. And what was said concerning that?

“A. I couldn't answer that.

“Q. You have no recollection?

“A. No. I know that we talked on a lot of points, because this final contract, I believe, would show that we didn't follow this.

“Q. You don't recall anything specifically said by you——

“A. I can remember discussing the cost matter, I can remember discussing this amount clause, how much they were to get, you know; I can remember discussing in a general way chemical specifications to this extent: He said, “Well, what are your chemical specifications?” I said, “I don't know a darned thing about chemicals,” I said, “You pick a man who attends to those things from your organization and I will designate a man from the California organization and let them determine what your chemical specifications should be.” We did put in quite a lot of words in arriving at that point, but what the words were I couldn't tell.

(Testimony of Stanley H. Barrows.)

Q. But you don't have any recollection of any specific [847] discussions with Mr. Colton or anyone else connected with or representing the Pacific Portland Cement Company with reference to the nature or type of costs that would be such as to entitle you to an increase in price?

“A. Well, what would entitle us to an increase was what we would finally decide upon, and we did talk that thing out and it took quite a long time, and that is what resulted in their finally changing the thing to just ‘cost of production.’ My thought was to ‘leave it to the accountants, what cost of production is.’

“Q. Do you recall anything specifically that Mr. Colton said with reference to that?

“A. No.

“Q. Do you recall anything specifically that you said, other than ‘leave it to the accountants, what the cost of production is’?

“A. That is my final remembrance.”

Now, has your recollection changed as to these discussions, Mr. Barrows, by reason of any new facts, memoranda, documents or other things that have come to your notice or attention since your deposition was taken this past October?

A. Not from any—

Mr. Rosenberg: Just a moment, Mr. Barrows. Mr. Bennett, you do not want the witness to understand that you have read to him all of the deposition pertaining to the discussion of that subject with Mr. Colton, do you? [848]

(Testimony of Stanley H. Barrows.)

Mr. Bennett: Well, no. The deposition is full of other discussions about other matters.

Mr. Rosenberg: No, the same matter. Read from page 21, line 1.

Mr. Bennett: I will be glad to go back to that early part if you wish, counsel. I thought I would save time under the admonition of the Court and get things moving faster.

The Court: Do anything but try the Court. Proceed.

Mr. Bennett: I am sorry, Your Honor. I meant no reflection.

The Court: I have been about so long, no matter what happened, it would not disturb me.

Mr. Bennett: As counsel has asked, I will read—you want me to start where?

Mr. Rosenberg: As long as the Court does not understand, or the witness does not understand you have purported to read from his deposition everything he said about the discussion with Mr. Colton on the subject of cost of production.

Mr. Bennett: I will go back. Where do you consider it starts?

The Court: Page 21, he said.

Mr. Bennett: What part? It starts with an answer. We would have to read back at the bottom of page 20, I presume:

“Mr. Bennett: Q. Will you state what that bone of contention was? [849]

“A. Well, it is pretty hard to remember, but I do recall this: In one case, in one of the drafts

(Testimony of Stanley H. Barrows.)

they submitted—well, I don't even know what you have in your file. You may have that. If I could see it, I could tell better, but we got to discussing what would be costs. I didn't want to limit it to the first items that we had outlined, because we got to figuring that we were going to have to put up the plant to make this gypsum. At first we thought we could put in a drier and then later it transpired we would have to put up a plant and put in equipment, and Colton put in a paragraph that the production costs—we were to have the right to decrease—keep records of the costs of production in form satisfactory to Pacific, and I said, "No, we can't do that, because I don't know what 'form satisfactory to Pacific' might mean. It might mean anything." And then I suggested, I countered with a "form in keeping with good accounting practice"—accepted practice, and I left that note with Williams, and I think—again it is awfully hard to remember these things ten years ago, but I think they said, "Well, we will just put in 'cost of production' and that will cover it. It is too involved to try to outline what every cost of production is." This is my recollection."

Mr. Rosenberg: I think that covers it.

Mr. Bennett: That is preliminary, Your Honor, to the further specific examination which I directed and which I first [850] read to the witness, and in which he said it was his suggestion to put in cost of production. Leave it to the accountants.

Q. Your testimony, including the questions asked

(Testimony of Stanley H. Barrows.)

and the answers given, was had on the 17th day of October of this year when you were a witness, Mr. Barrows?

A. If it is in there. I do not remember the date. I would have to check it.

Q. You have just read it, have you not?

A. Yes.

Q. And you gave that testimony at that time?

A. That is correct.

Q. Since that date have you located any records, papers or documents that contain any information or memoranda as to what was said between you and Mr. Colton with reference to this contract?

A. No, I have not. However, when this deposition was taken that letter of June 18, that form of contract submitted on September such and such a date— I guess it was June 5 and September 18—

Q. You are referring now to your letter of June 5?

A. Yes, which was shown to me as you were questioning me.

Q. And your letter of June 18?

A. And the final contract was the first time I had looked at them for a long time, and it is pretty hard to remember out of [851] a clear sky just what you said. In other words, if that had been correctly answered, I would say we discussed every paragraph in that contract.

Q. As a matter of fact you did?

A. Back and forth during that period, so that would cover every paragraph.

(Testimony of Stanley H. Barrows.)

Q. You discussed almost every paragraph?

A. Yes, we did, including all of these things we have talked about.

Q. You even changed the base of comparison or, rather, discussed changes in the basis of raises. Originally you had proposed that any increase in cost would be an increase over the cost of the base period?

A. Well, I do not not remember that, but whatever is in the contract we did discuss and whipped it out.

Q. But at the time your deposition was taken the great bone of contention was Pacific's or Colton's suggested request that you keep your books of account in a form satisfactory to Pacific, wasn't that it?

A. No, I would not say that that was the great bone of contention. The bone of contention was how we would arrive at cost of production. During that period, if I may deviate slightly, our process in making contracts was to get first a rough draft, such as we submitted on the 18th, which goes to Colton. Then a copy of that goes to our different departments: [852] our accounting department, our sales department, and I asked for suggestions how the different clauses could be more properly or more advantageously written, and our accounting department might have come back—as I say, I can't remember twelve years—but they might have come back and called my attention, "Over the long period of the contract you are not covering costs;

(Testimony of Stanley H. Barrows.)

that can be very troublesome.” And so that is the bone of contention. That is what brought up the cost.

Q. There was a bone of contention that Pacific suggested you keep your books in a form satisfactory to them?

A. That is right, that was about the third or fourth draft—the third draft, let us say.

Q. You objected to that? A. Sure.

Q. But you can't recall now on June 5, 1936, when you first made the proposal to Pacific, all that you were concerned in a price protection clause was advances in labor, materials and power.

A. I remember that those were the items that were mentioned.

Q. Within a few months later, in September when you wrote your letter of September 18 and submitted a proposed draft, the contract that had been prepared by your lawyer——

A. That is right.

Q. Again, all that you were proposing was price protection against increases of the direct cost of labor, and so forth? [853]

A. That is right, used as a starting point, however. That does not mean a final——

Q. You talked to your department heads and other people between June 5, 1936, and September 18, 1936, hadn't you, Mr. Barrows?

A. Not in regard to the contract. That first con-

(Testimony of Stanley H. Barrows.)

tract that you see, September 18, is the copy that would go out to the different department heads and then they would come back and make suggestions.

Q. As I understand it, then, your view, or at least what you were contending with Colton, according to your final recollection, was any actual increase in the cost of production or the cost of manufacture of this byproduct gypsum would be left to the accountants to determine; is that what you had in mind?

A. I would think that is essentially correct, following accepted accounting practice.

Mr. Bennett: Thank you, Mr. Barrows. That is all.

Mr. Rosenberg: No further questions.

The Court: You may step down. [854]

DAVID WATT,

called as a witness on behalf of defendant; sworn.

The Clerk: Will you state your name to the court?

A. David Watt.

Direct Examination

By Mr. Rosenberg:

Q. Mr. Watt, where do you reside?

A. Hayward, California.

Q. By whom are you employed?

A. Westvaco Chlorine Products Company.

(Testimony of David Watt.)

Q. In what capacity? A. Office manager.

Q. How long have you been in the employ of that company? A. Since August 1, 1937.

Q. In what capacity were you first employed?

A. As an accountant.

Q. How long did you continue in that capacity?

A. Until 1941.

Q. What duties did you take up in 1941; did you become office manager?

A. No; assistant office manager.

Q. When did you become office manager?

A. I became acting office manager in October, 1944, and was named office manager in January, 1945.

Q. What are your duties as office manager?

A. General supervision of the accounting department. [855]

Q. What training and experience have you had in the accounting field?

A. Well, prior to coming to this country I was an accountant and auditor in Africa for ten years. I came to this country in 1929 and was employed by the New York Telephone Company. In 1931 I came to California, and worked for Arthur Anderson & Company, certified public accountants, Eugene Berger & Company, certified public accountants. I also worked for Elliot Nugent, actor and director at Metro-Goldwyn-Mayer, the Electograph Service Company. In 1933 I went to work

(Testimony of David Watt.)

for American Potash & Chemical Company, Trona, California. In 1937 I started working for Westvaco.

Q. What education have you had in accounting?

A. Well, I was educated in Scotland, at Skerry's College.

Q. Other than your accounting work and education, what experience have you had in cost accounting, other than your experience with Westvaco Chlorine Company?

A. I had some experience in Africa, but most of my cost experience has been with Westvaco.

Q. Have you brought with you your work sheets on these moisture credits? A. Yes.

Mr. Rosenberg: At this time I would like to offer in evidence, if the Court please, Exhibit H that was offered for identification. I wanted to compare it with the original. [856] There appears to be some typographical errors in there, but the same appear in the original, so apparently that is a true copy.

The Court: It will be admitted and marked, subject to any corrections you wish to make.

(Thereupon Defendant's Exhibit H For Identification was admitted and marked in evidence.)

(Testimony of David Watt.)

DEFENDANT'S EXHIBIT H

California Chemical Company
Mills Tower, 220 Bush Street
San Francisco

September 18, 1936.

Mr. J. H. Colton, Vice-President
In Charge of Operations
Pacific Portland Cement Company
111 Sutter Street
San Francisco

Dear Mr. Colton:

Enclosed herewith you will find copy of our first attempt to outline conditions in the proposed contract between our respective organizations, covering shell lime and gypsum.

I am leaving for the East the last of this month and should like, if possible, to get contract in final form and executed prior to my departure. I will be tied up on Wednesday and accordingly if you can get the matter in shape for discussion on either Monday or Tuesday, I can arrange to meet you on either of those days.

Will you, therefore, please telephone me when you are able to meet with me to further discuss conditions therein.

Very truly yours,

CALIFORNIA CHEMICAL
COMPANY,

By /s/ STANLEY H. BARROWS.

SHB:P encl. Dictated but not read.

(Testimony of David Watt.)

This Agreement, made and entered into this day of, 1936, by and between Pacific Portland Cement Company, a California corporation, (hereinafter called "Pacific") party of the first part, and California Chemical Company, a Delaware corporation, (hereinafter called "California") party of the second part,

Witnesseth:

Whereas, California uses certain oyster shell in the operation of its business; and

Whereas, California further contemplates erection of a plant located on Canal Head, at Newark, California, to manufacture magnesium oxide and other products by reacting calcined oyster shell and magnesium chloride, and as a result of said operations would also produce gypsum and calcined quicklime; and

Whereas, Pacific is desirous of selling oyster shell to California from certain deposits of oyster shell owned or controlled by said Pacific on the Bay of San Francisco; and

Whereas, Pacific is further desirous of purchasing from California certain parts of the gypsum and quicklime as and when the same is manufactured by California in the plant which, as is hereinabove set out, California contemplates erecting at Newark, California:

Now, Therefore, the parties hereto in consideration of the promises and covenants of the other herein contained, mutually promise and agree as follows, to-wit:

(Testimony of David Watt.)

1. That Pacific hereby grants to, and California shall have the right for the period of thirty (30) years commencing on the 1st day of January, 1937, and ending on the 31st day of December, 1966, at its own cost and expense, to enter upon, dredge for and remove from beds owned or controlled by Pacific situate on the Bay of San Francisco at such points or places on said beds as may be agreed upon by the parties hereto, all suitable oyster shell required by California in the operation of its plants situate in the State of California. In this connection it is understood and agreed that as California requires a certain type and quality of shell for its operations, that all dredging operations shall be at points or places on said oyster beds owned, leased or controlled by Pacific as will furnish or produce oyster shell suitable for the uses and operations of California, it being further understood that California shall be the sole judge as to the suitability for its uses and operations of all shell dredged, and in case no shell suitable for the uses and operations of California can be obtained from such beds, owned or controlled by Pacific, then and in that case this agreement shall be null and void upon California notifying Pacific in writing that oyster shell suitable for its purposes and operations cannot be obtained from the beds hereinabove referred to owned, leased or controlled by Pacific.

2. California agrees to pay to the order of Pacific at its office in the City and County of San

(Testimony of David Watt.)

Francisco, for all oyster shell removed from its properties, the following sums:

(a) 5c for each cubic yard of clean washed shell, dredged and removed by California from beds owned, leased or controlled by Pacific, situate in Alameda County.

(b) 20c per ton for each ton of washed shell, figured on a dry basis, dredged and removed by California from beds owned, leased or controlled by Pacific, situate south of Dumbarton, California. The method of determining quantities so dredged and removed by California shall be mutually agreed upon hereafter by the parties hereto, and said methods so agreed upon shall be made a part of the within agreement. All payments provided for herein shall be made by California on the 15th day of each month for the quantities dredged and removed by California during the preceding calendar month.

It is further expressly understood and agreed by and between the parties hereto that commencing with the 1st day of January, 1937, said California shall dredge and remove from the points or places agreed upon and designated by the parties hereto, all oyster shell consumed, sold or otherwise used by California in its operations during the term of this agreement, and further agrees to pay for said shell at the rates and in the manner hereinbefore set out. In case California should, during any year or years of this agreement, dredge and remove less than \$1800.00 worth of shell in accordance

(Testimony of David Watt.)

with the prices hereinabove set out, then California agrees on the 15th day of January after said year or years, to pay to Pacific the difference between the amount of shell removed, during said year or years, and the sum of \$1800.00.

California agrees that at the time of making payments for said oyster shell, it will deliver to Pacific full, true and correct statements of the account showing the amount of oyster shell removed from the properties of Pacific during the preceding month in accordance with the method of measurement agreed upon by the parties hereto. It is agreed that Pacific shall have at all reasonable times access to the books and accounts of said California relating to the amount of oyster shell removed from the properties of Pacific.

3. In case oyster shell suitable for the uses and operations of California cannot be obtained from the properties or oyster beds owned, leased or controlled by Pacific situate in Alameda County or south of Dumbarton, California, and suitable shell for the uses and operations of California can be obtained or produced from oyster beds owned, leased or controlled by Pacific situate in other parts of the Bay of San Francisco, then California shall have the option, if it so desires, to dredge for and remove oyster shell from said other properties or oyster beds owned, leased or controlled by Pacific situate in other parts of the Bay of San Francisco. In case said California should dredge and remove oyster shell for such other properties

(Testimony of David Watt.)

of Pacific as hereinabove set out, California agrees to pay to Pacificc for each cubic yard of washed shell so dredged and removed from said properties, said payment to be made at the times and in the manner hereinabove set out, it being understood, however, that the dredging of said other properties owned, leased or controlled by Pacific hereinabove referred to shall be at points or places designated by Pacific.

4. If and when California should erect the plant hereinbefore referred to on its properties situate on Canal Head, at Newark, California, and may produce in said plant gypsum or calcined lime, it is hereby agreed that California will sell, and Pacific agrees to buy from California, all gypsum produced by California during each year of the term of this agreement in excess of 3,000 tons per year, which California shall have the right to retain and to be disposed of in the manner herein-after provided, but in no event shall the amount of gypsum agreed to be sold and purchased, as provided by this paragraph, exceed 20,000 tons per year.

Pacific agrees to pay to the order of California, at its office in the City and County of San Francisco, for all gypsum sold to Pacific by California, the following sum:

\$2.80 for each ton of gypsum loaded in bulk on cars at the Newark plant of California, said payment to be made on the 15th day of each month for the quantity shipped to Pacific during the pre-

(Testimony of David Watt.)

ceding calendar month. Pacific agrees that it will accept from California all gypsum produced by California during each month of the term of this agreement in excess of 250 tons per month, but in no event to exceed the amount of 20,000 tons per month; but in this connection it is agreed that on the first day of each month California will advise Pacific of the amount of gypsum which it contemplates producing during said month, and Pacific agrees to accept delivery of said amount by the end of the succeeding calendar month, subject, however, to the condition that Pacific shall not be required to accept more than 20,000 tons of gypsum in any year.

It is further agreed that California shall have the right to sell to persons or corporations other than Pacific up to 3,000 tons of gypsum per year for chemical, pharmaceutical and/or certain other scientific or industrial purposes, it being agreed, however, that California will not sell any of the gypsum produced in the plants hereinabove referred to for plaster, agricultural or building purposes.

5. If California should produce calcined lime in said plants hereinabove referred to from shell obtained and purchased from Pacific, California agrees to sell to Pacific during each year of the term of this agreement up to 9,000 tons of calcined lime produced in said plants, provided Pacific will agree to purchase from California a designated amount of tons of calcined lime each year

(Testimony of David Watt.)

for a period of years satisfactory to California, and which said agreement shall be entered into in writing and made a part of this agreement.

Pacific agrees to pay to the order of California, at its office in the City and County of San Francisco, for all calcined lime sold to Pacific by California, the following sums: \$6.50 per ton for bulk quicklime loaded on cars at the Newark plant of California; \$8.50 per ton for all hydrated lime in four-ply paper bags, loaded on cars at the Newark plant of California; said payments for said lime to be made on the day of each month for the quantity shipped to Pacific during the preceding calendar month.

Pacific agrees that it will give California at least thirty (30) days notice of the amount of bulk quicklime or hydrated lime that it will require for the succeeding calendar month, but in no event shall California be required to deliver more than 750 tons of calcined lime in any one month. It is hereby agreed by and between the parties hereto that Pacific will not use or sell calcined lime for industrial or chemical purposes, and that California shall have the right to continue to sell quick or hydrated lime for industrial and chemical purposes as at present, it being understood, however, that California will not sell or use quick or hydrated lime for construction or agricultural purposes, other than insecticides.

6. The prices hereinabove stipulated to be paid by Pacific for gypsum, quicklime and hydrated lime

(Testimony of David Watt.)

are based upon the average direct cost to California to produce the materials covered by this agreement during the first year's operation of the contemplated new plant proposed to be erected at Canal Head, Newark, California, and it is therefore understood and agreed that in the event of price advances and labor, transportation, fuel or supplies resulting in an increase of 5% or more in cost above the first year's average direct cost hereinabove referred to, f.o.b. cars shipping point, then and in that event California shall have the right to increase the price to Pacific to the extent of the increase above the said average direct production cost for lime or gypsum.

7. It is further understood and agreed that as California is at present selling oyster shell for industrial, poultry and agricultural purposes, it shall have the right to continue to sell oyster shell for said purposes, and shall have the right to use shell purchased from Pacific for said purposes and uses; and in this connection it is understood and agreed that certain agreements exist between California and American Smelting & Refining Company for the sale and purchase of oyster shell to be used by said American Smelting & Refining Company in its plant at Selby, California, and that therefore California shall have the right to deliver and sell to said American Smelting & Refining Company oyster shell purchased and received by California from Pacific.

(Testimony of David Watt.)

8. In the event that any of the provisions herein contained, or any practice or action herein provided for would be in violation of any law or laws of any State, or of the United States with respect to restraints or trade or otherwise, then to that extent said provisions of this agreement shall be deemed to be of no force or effect whatsoever, and there shall be no obligation in such event upon either of the parties hereto to abide by or conform to said provision of this agreement.

9. California further agrees that during the term hereof all dredging operations conducted by California shall be done in a good and workman-like manner, and at the sole cost, charge and expense of California without cost, expense or liability whatsoever to Pacific, and California covenants and agrees to indemnify and hold harmless Pacific from any and all costs, liability, charges and expenses in any manner incurred by it in the performance of this agreement, and California further agrees that it will comply with all the rules and regulations of the United States or of the State of California covering said dredging, and further agrees to comply with all the rules and regulations required by the so-called Workman's Compensation laws and the so-called Accident Commission of the State of California, and agrees to fully indemnify and save harmless Pacific from any loss, liability, damage or obligation on account of any injury to any employee of said California engaged in said dredging.

(Testimony of David Watt.)

10. It is further agreed that California shall not be liable for any failure to make deliveries hereunder if such failure results from prevention or interference by exercise of governmental authority, acts of God, floods, embargo, war, civil uprisings, fire, strikes, lockouts, or any other causes beyond the reasonable control of California. Further, such failure shall in no way affect the obligations of the parties hereto under this agreement, except as to such orders which are not filled owing to such prevention or interference. If delay in fulfilling the same continues for more than thirty (30) days, then Pacific may procure its requirements elsewhere until California is ready to assume deliveries.

11. It is further agreed by the parties hereto that they will not, directly or indirectly, void their obligation hereunder by conducting their said business through a subsidiary or any affiliated corporation, or any corporation controlled, directly or indirectly, by either of them, their officers, directors or stockholders, or the relatives of any of them, and further agree that in the event that there is a transference through said subsidiary or corporation or person, that such corporation or person will comply with all the terms and conditions hereof as if a signatory party hereto.

12. It is further understood and agreed that California shall have the right to cancel this agreement at any time upon giving written notice to Pacific of its intention so to do, by delivering such written notice to said Pacific at least one (1) year

(Testimony of David Watt.)

prior to the date of cancellation. The said cancellation shall not become effective unless and until one (1) year's notice has been given, and during said year California shall have the right to continue to operate under this agreement.

13. It is further understood and agreed that any notice, order, demand or communication under or in connection with this agreement may be served upon California by personal service, or by mailing the same by registered mail in the United States Post Office, postage thereon fully prepaid and directed to California at 220 Bush Street, San Francisco, California, and may likewise be served on Pacific by personal service, or by mailing the same by registered mail in the United States Post Office, postage thereon fully prepaid and directed to Pacific at 111 Sutter Street, San Francisco, California.

Either party may change its address by notifying the other party in writing as to such new address as either party may desire used, and which same shall continue as the address of said party until further written notice; and it is further agreed that the mailing of said notice or notices as herein provided shall be a full compliance with the provisions of this agreement with respect to the giving of notices.

14. This agreement shall bind and inure in favor of the parties hereto, their respective successors and assigns.

In Witness Whereof, the said parties hereto have caused their corporate names to be hereunto subscribed and their corporate seals to be hereunto

(Testimony of David Watt.)

affixed by their respective officers thereunto duly authorized the day and year first hereinabove written.

PACIFIC PORTLAND
CEMENT COMPANY,

By

By

CALIFORNIA CHEMICAL
COMPANY,

By

By

Q. (By Mr. Rosenberg): Mr. Watt, have you prepared a statement from the records of the Westvaco Chlorine Products Company showing the deductions taken by Pacific Portland Cement Company pursuant to paragraph 5 of the contract?

A. Yes. This is the statement.

Mr. Bennett: Now, can't we reach it in a better way, Counsel? To shorten time, I am anxious to do that, but you objected to our witnesses construing the contract, and I would necessarily have to interpose an objection here, not knowing what testimony will be given.

Mr. Rosenberg: I said deductions by Pacific Portland Cement Company pursuant to the contract.

Mr. Bennett: I am sorry. Go ahead.

Mr. Rosenberg: Can't we stipulate to——

Mr. Bennett: Yes, if I can stipulate to anything to save time I will be glad to do it.

(Testimony of David Watt.)

Mr. Rosenberg: Let me offer a stipulation and see if you can agree with it: That from the inception of this contract [857] and up to the present time as shipments of gypsum have been received by Pacific Portland Cement Company, the Pacific Portland Cement Company apparently has made tests of the shipments in their laboratory and then based upon their analyses in making remittances to Westvaco Chlorine Products Company, they have deducted from the invoice, taken such deductions as they feel they are justified in taking pursuant to paragraph 5 of the agreement, and that in making such deductions Pacific Portland Cement Company has taken a credit of 10 cents per ton and a fractional part thereof for each per cent—strike that where I said “in making such deductions”—that in taking such deduction——

The Court: May I make a suggestion? I will take a recess for a few minutes. You can indicate what you expect to prove and let the other side know it, and probably you can save some time.

(Recess.)

Mr. Rosenberg: Your Honor please, paragraph 5 of the agreement provides in substance that in the event that the gypsum delivered under the contract shall not be within 2 per cent in gypsum content of the chemical analysis set forth as Exhibit A of the contract, then Pacific shall have the option either to refuse to accept and pay for the gypsum, or it may accept the gypsum and pay therefor 10 cents per ton less than the price provided for in the

(Testimony of David Watt.)

contract for each per [858] cent, which the gypsum falls below the chemical analysis.

Now, the chemical analysis provides for 97.51 gypsum content, and I think that the parties are agreed now that unless the gypsum content falls below that 2 per cent tolerance, or 95.51 per cent, no deductions are permissible under this paragraph.

Mr. Bennett: Yes, your Honor. I have stated that before, and that is our position now and in the future.

Mr. Rosenberg: It is the position of the defendant that if the gypsum content falls below 95.51 per cent that Pacific nevertheless is permitted to deduct 10 cents per ton for each full per cent that it falls below 97.51 per cent under the wording of the contract, that if it does so fall below 95.51 per cent that Pacific shall pay therefor 10 cents per ton less than the price provided for in the contract for each per cent which it falls below that percentage; Pacific, on the other hand, contends that if the gypsum content falls below 95.51 per cent then Pacific is entitled to a credit of 10 cents per ton, or fractional part thereof for each per cent or fractional per cent that the gypsum content is less than 97.51 per cent. That is right?

Mr. Bennett: That is correct.

Mr. Rosenberg: Now, I believe that we can stipulate that defendant, and I might say preliminarily that there is some difference between the parties by reason of the fact that the analyses of the gypsum which are made, or which have been

(Testimony of David Watt.)

made by Westvaco at its laboratory at Newark do not agree in all cases with the analyses made by Pacific at its Redwood plant,— [859] is that where they are made?

Mr. Bennett: Yes, that is correct.

Mr. Rosenberg: At its laboratory in the Redwood City plant, and, furthermore, as I say, there is a further difference by reason of these fractional amounts and it is admitted by Pacific that they have, as they state, through error taken certain deductions by reason of the 2 per cent tolerance and they tendered a check for \$539—

Mr. Kaapcke: \$539.24.

Mr. Rosenberg: \$539.24, which was not accepted for the reasons which have previously been stated.

I think we can stipulate to this, that according to the analyses of the gypsum made by Westvaco at Newark and not allowing any fractional per cent deductions, the records of Westvaco Chlorine Products Company show that for the period from December, 1940, to August, 1944, Pacific has taken deductions in the sum of \$514.91 in excess of those which they would be entitled to if the chemical analyses made by Westvaco are correct, and if we are correct in our interpretation of the contract that only full percentage deductions are permissible, and on the same basis for the period from September 25, 1944, to October 23, 1946, that Pacific has taken deductions of \$1653.20 in excess of what they would be entitled to according to our analyses, that

(Testimony of David Watt.)

is, Westvaco's analyses and Westvaco's interpretation of the contract. In other words, I think I can [860] state for those same periods Pacific admits that it owes——

Mr. Kaapcke: \$539.24.

Mr. Rosenberg: On account of——

Mr. Kaapcke: Inadvertence in not allowing tolerance in certain cases.

Mr. Rosenberg: Yes. Is there something you would like to add to that?

Mr. Kaapcke: Just a couple of sentences, I think. Your Honor, I would like to suggest to you and to Mr. Rosenberg that that stipulation is acceptable to us if it be modified by the addition of two further facts, and I think, Mr. Rosenberg, that you won't have any difficulty in agreeing on it. First, the tests made by Pacific at its Redwood City laboratory have been tests of samples furnished by Westvaco, which samples were taken at the Westvaco plant. The second supplement would be this, that according to Pacific's chemical analyses and if its analyses are correct after allowing for the \$539.24, which they concede to be due, Pacific's records would show that it has paid all sums it is obliged to pay under the contract. Is that satisfactory to you?

Mr. Rosenberg: Yes, that is all right. I should add that on a payment which Pacific made to Westvaco under date of November 10, 1947, they took a further credit of \$250.28 for shipments made during the month of September, 1947, where, ac-

(Testimony of David Watt.)

According to their analysis, the gypsum content fell [861] below 95.51 and which amount is computed on the basis of fractional per cent, and which deduction, according to our analysis, is likewise not justified; in other words, our analysis shows that all of those shipments had the gypsum content exceeding 95.51, so that is in controversy as well.

Mr. Kaapcke: That supplementary amount, I take it, may be applicable under the stipulation we have just entered into.

Mr. Bennett: Except the problem of the 2 per cent tolerance is not present in that.

Mr. Rosenberg: That's right. I might say this, if the Court please, that counsel and I concede that the actual amounts of money involved, these are the matters that are involved in our counterclaim—are relatively, at least, unimportant. However, they involve a phase of the contract which if the parties are going to operate under the contract in the future the court is going to have to interpret. In other words, the court is going to have to interpret, is going to have to say what the contract means, whether the analyses made at Newark are to control or the analyses made at Redwood City are to control, and whether the contract says that the payments are to be for each per cent, that means each per cent or fractional per cent, so it is a matter of determination or interpretation for the future as well as for the purpose of determining the settlement of the present amount.

Mr. Bennett: I think in that case, your Honor, at the [862] risk of prolonging the time factor of

(Testimony of David Watt.)

this trial that I believe the real and only question other than the ultimate determination by the court as to whether the defendant is entitled to a credit of some \$1500 or whether it is entitled to nothing, that you are going to determine which laboratory was right.

The Court: How can that be determined?

Mr. Bennett: I hope we can save your Honor that burden. There is the more important thing involved here. If it is possible for us to resolve these little differences, differences that arise whenever a contract has a requirement for quality of content, that every effort should be made by counsel and the principals to resolve that matter and save this court the time that would be taken in testing which one of these laboratories is to be believed, and I hope that before the final submission of this case to the court that that determination of the actual cents and dollars in this comparatively trivial aspect will be resolved by the parties. Your Honor will further be called on to interpret the contract in one particular, in this relatively minor aspect, as to whether fractions of deductions are to be allowed, but I don't think we need to take up that aspect, we are all of us striving, under your Honor's admonition to get the case submitted as quickly as possible so when the trial is over I think maybe that aspect could be covered by argument or briefed at a [863] later juncture. I just want to indicate that parties in most instances of contracts involving measurements, and so forth, resolve their

(Testimony of David Watt.)

differences rather than burdening this court with sitting for hours and days to try that aspect of the matter. [863-a]

Q. (By Mr. Rosenberg): Mr. Watt, you are familiar, are you, with the fact that back in 1941 the price of gypsum under the contract was increased from \$2.80 a ton to \$2.98 a ton? A. I am.

Q. Can you state during what period of time Pacific Portland Cement Company paid Westvaco at the \$2.98 price?

Mr. Bennett: Isn't that all in the record by the stipulation?

The Witness: Up to 1945, some time in 1945.

Mr. Rosenberg: I think you are right. I think the record shows it was until some time in 1946.

Mr. Bennett: Subject, of course, to these little deductions that were mentioned here, that were gone into quite fully by Mr. Flick.

Mr. Rosenberg: I think perhaps we can stipulate also, can we, Mr. Bennett, that on October 16, 1946, Pacific paid Westvaco——

(Discussion between counsel off the record.)

Mr. Bennett: That is covered.

Q. (By Mr. Rosenberg): I believe you stated that you are the head of the accounting division of the Newark plant, are you?

A. That is correct, yes.

Q. There has been testimony to the effect that the depreciation that is charged to gypsum is computed on a straight-line basis, is that correct?

A. That is true. [864]

No. 12054

United States
Court of Appeals
for the Ninth Circuit

PACIFIC PORTLAND CEMENT COMPANY,
a corporation,

Appellant,

VS.

WESTVACO CHLORINE PRODUCTS COR-
PORATION, a corporation,

Appellee.

Transcript of Record

(In Three Volumes)

VOLUME III.

(Pages 901 to 1329, inclusive)

Appeal from the United States District Court
for the Northern District of California,
Southern Division

FILED

FEB 16 1949

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(Testimony of David Watt.)

Q. Will you state what depreciation is charged to gypsum, that is, depreciation on what portion of the entire plant?

A. Depreciation on the gypsum plant only.

Q. What do you describe as the gypsum plant?

A. The portion of the main plant where the gypsum is manufactured.

Q. Does that mean the filter, the drier—

A. The filter, the drier and the loading equipment.

Q. And the what?

A. And the loading equipment.

Q. And the grinding?

A. And the grinding and the warehousing.

Q. That is devoted to gypsum?

A. Gypsum only, yes.

Q. In your opinion, is the straight-line method a proper method for computing that depreciation?

A. For a chemical plant such as ours, I do not know what other kind of method you would use. After all, in a chemical plant where you have salt of any kind, the corrosion is so high, I do not know how else you could use depreciation other than on a straight-line method.

Q. Would there be any variance in the corrosion or wearing of equipment according to the quantity of product produced in it?

A. Oh, no, not at all.

Q. So that you feel that the straight-line depreciation is the [865] proper basis upon which to compute the depreciation of the plant? A. I do.

(Testimony of David Watt.)

Q. (By the Court): Familiarize me with the straight-line method again.

A. That is a composite method overall. Instead of taking various depreciation rates for individual pieces of equipment, you use the composite rate over the whole plant.

Q. (By Mr. Rosenberg): Is straight-line depreciation based upon the estimated life of the property? A. Yes.

Q. And you depreciate the property on a straight-line basis or, in other words, at so much per year spread over the expected life of the property?

A. For a given period of years, yes.

Q. With reference to taxes, will you state on what property taxes are charged to gypsum?

The Court: Real property?

Mr. Rosenberg: That is what I am asking, your Honor.

Q. In other words, in these various accounts under the cost of production of gypsum, there appears an item for taxes. What does that include?

A. That includes property taxes.

Q. On what?

A. On the whole of the plant, and then the whole taxes, the [866] tax cost is split on the plant value and allocated to the various departments on the value of the equipment in these departments.

Mr. Rosenberg: I hope you won't object to this, Mr. Bennett. I am going to ask a leading question.

(Testimony of David Watt.)

Q. Is this true, that for the purpose of allocating taxes to gypsum you charged to gypsum such proportion of the taxes on the entire plant as the value of the gypsum plant bears to the entire plant?

A. That is correct.

Q. Can you state whether or not substantially the same method is employed in allocating insurance?

A. The same method.

Q. Now, there has been mentioned throughout the testimony repair labor. Will you explain what that is? What type of labor falls within that category?

Mr. Bennett: If it may save time, we are not questioning that repair labor that is directed to any part of this plant or machinery devoted to the gypsum is not a proper charge. We have taken the position all along that it is, Your Honor. I say that there is no question about that. If repair labor of the category of overhead, that is, not on a direct basis, has to be allocated on some reference basis, then, of course, we would object to that because it injects the element of conjecture and uncertainty where the contract requires, [867] according to our understanding of the language used, the actual increase of the cost of manufacture, which is not consistent with anything involving uncertainties or speculation.

Q. (By Mr. Rosenberg): There has also been mentioned supervision labor. Will you explain what category of labor falls under that head?

A. Plant supervisors.

(Testimony of David Watt.)

Q. What are the functions of the plant supervisors?

A. Well, they are what you call shift supervisors and they are in charge of the whole of the plant during their various shifts.

Q. When you speak of the whole plant, does that include the gypsum plant?

A. Oh, definitely.

Q. When you say they are in charge of it, what are their duties?

A. Well, the supervisors at the Newark plant are all chemical engineers and they have to supervise all processes.

Q. And that would include the gypsum processes? A. Definitely.

Q. Is there any other type of labor that falls within that category? A. No.

Q. That is all. With reference to indirect shipping expenses, will you describe to the Court what they consist of?

A. Indirect shipping expense consists of shipping department [868] supervisor, his assistant, shipping clerks, and any other miscellaneous charge that cannot be directly allocated to any given product.

Q. Such as what?

A. Janitor sweeping up the warehouse, anything miscellaneous of that description.

Q. Will you describe your shipping department over there and tell us what products are handled out of that department? The labor that is contained

(Testimony of David Watt.)

in your statements under the description of shipping labor, who are the parties who perform those services? A. Is that direct or indirect?

Q. Direct.

A. That is the shipping—the men in the shipping department who handle the various products of loading in into cars, bagging it, or whatever the case may be.

Q. And the ones whom you include under indirect you state are foremen, assistant foremen?

A. That is correct.

Q. Would that include a shipping clerk?

A. Yes.

Q. Tractor operator? A. No.

Q. Not that? A. Not that. [869]

Q. To the shipment of what products do those employees devote their time and efforts?

A. All products going out of the plant.

Q. Would that include gypsum?

A. Definitely.

Q. Would it be practical or possible for those employees to keep records of their time, indicating the amount of time that they spent on shipping each of the various products that they handle?

A. It would be impossible.

Mr. Bennett: Now we are talking about the so-called indirect.

The Court: Shipping expense.

Mr. Bennett: Indirect. There are two classes, I understand: one of direct, which there is no dispute about, and this is indirect.

(Testimony of David Watt.)

Q. (By Mr. Rosenberg): There has been some discussion of the charges for work in the laboratories at Newark. Will you describe the laboratories, that is, just what laboratories or laboratory accounts enter into your cost accountants at Newark?

A. Well, we have only the one laboratory, that is, the control lab.

Q. How is the time in the control laboratory or the expense charged to the various products that are handled in there?

A. Each chemist keeps a daily time card on which he allocates [870] his time to the various products that he analyzes.

Q. How is that charged? Directly to the product?

A. Directly to the product.

Q. Are there any indirect laboratory charges?

A. Yes.

Q. What do they comprise?

A. Your chief chemist, your assistant chief chemist, I believe one stenographer, janitor, miscellaneous supplies that are used overall that cannot be allocated to given products.

Q. How are those charges distributed?

A. They are allocated to all products.

Q. Including gypsum?

A. Including gypsum.

Q. On what basis?

A. On the basis of the direct charges to the various products.

(Testimony of David Watt.)

Q. When you are talking of the direct charges, do you mean the direct charges in the laboratory?

A. Yes.

Q. In other words, those are not distributed on the same basis as your general overhead?

A. Oh, no.

Q. Getting into general overhead, those are distributed on what basis?

A. On a direct labor basis.

Q. There has been some mention of a research laboratory. What [871] is that?

A. The research lab?

Q. Yes.

The Court: This same laboratory?

A. No, a different laboratory altogether.

Q. You said there was only one laboratory?

A. Well, there is only one control laboratory.

The Court: That is all right.

Mr. Bennett: I think Your Honor's question is very pointed.

The Court: I only wanted to follow his testimony.

Q. (By Mr. Rosenberg): In other words, there is another laboratory, is there?

A. Oh, yes, sure.

Q. And that is what?

A. The research laboratory.

Q. What services are performed in that laboratory?

A. Well, I would say testing, improving, working out new analyses, trying to find new products.

(Testimony of David Watt.)

Q. New products to derive from bittern?

A. To derive from bittern, yes.

Q. How are those charges in that laboratory distributed?

A. On the same basis: directly to the products where it can be distributed.

Q. And the supervisor or general or miscellaneous are [872] distributed on what basis?

A. Allocated on the direct basis.

Q. By direct basis what do you mean?

A. I mean those charges already charged to the various products by the research chemist.

Q. In other words, the general or indirect charges in the research laboratory are charged with the various products in the plant in the proportion that the direct labor performed in the laboratory on the various products bear to the entire expense of the laboratory?

A. That is correct.

Q. I think I neglected to ask you how the indirect shipping expenses are allocated among the various products.

A. Allocated on a tonnage basis.

The Court: Develop that.

Mr. Rosenberg: What is that?

The Court: Just to say they are allocated on a tonnage basis, you had better develop that situation.

Q. (By Mr. Rosenberg): Yes. Will you explain what you mean by that, Mr. Watt?

(Testimony of David Watt.)

A. Well, each month we sell so many tons of all the products that we produce, and we have a certain amount of indirect shipping expense; so the indirect shipping expense is spread over the tonnages that we sell each month.

Q. In other words, they are charged to the various products in [873] the proportions that the tonnages of each product handled bears to the whole?

A. Yes, that has been shipped out of the plant.

Q. Has that always been the method of allocation employed at the plant?

A. No, it has not.

Q. When was there a change in that method?

A. The change was made about the middle of 1945.

Q. Prior to that time what had been the basis of allocation?

A. The dollar value of the products sold each month.

Q. In other words, the indirect expenses were spread between the various products according to the dollar value of each product related to the whole?

A. Yes, that is correct.

Q. What was the reason for making that change?

A. The reason for making the change was that in my estimation dollar value had nothing to do with shipping. The only way that I could see that shipping expense should be allocated was on tonnage handled by the shipping department.

(Testimony of David Watt.)

Q. Could you state approximately how the quantity of gypsum produced in the plant compares to the quantity of magnesia?

The Court: Tonnage?

Mr. Rosenberg: Tonnage.

The Witness: Roughly, 50 per cent.

Q. (By Mr. Rosenberg): About 50 per cent?

A. 50 per cent.

Q. You mean of the whole?

A. Of the whole, yes.

Q. In other words, the amounts of each are approximately the same? A. Yes.

Q. In distributing these various costs at the Newark plant, can you state whether or not you employed the same methods or principles with relation to each product there? A. Absolutely.

Q. In other words, you do not have one method for gypsum and some other method for some other product? A. No.

Q. Your accounting methods are uniform as to all products, is that right?

A. For all products, yes.

Q. Now, you stated that general overhead is allocated among the various products at the plant on what basis? A. Direct labor.

Q. Will you explain what you mean by that, Mr. Watt? Just explain your procedure. Elaborate on it a little. [875]

A. Each product made has a certain amount of operating and repair labor, so general overhead is allocated to each product on the sum of the oper-

(Testimony of David Watt.)

ating and repair labor as it bears to the whole of the operating and repair labor throughout the plant.

Q. Has there been any change in accounting practice in that respect at any time?

A. Yes, we did change. January, 1946, I believe it was that we changed.

Q. What change occurred at that time?

A. In January, 1946, we went to direct labor as the basis, which is the operating and repair labor. Prior to that we spread overhead on the combined supervision and operating labor only.

Q. Mr. Watt, I will show you the defendant's answer to interrogatory 10-E. Did you provide the information that is contained in that answer?

A. I did.

Q. Will you just relate the changes in accounting practices that have taken place during the time that this contract has been in effect?

Mr. Bennett: To save time, if nothing else, Counsel, are you just going to have the witness read the changes that have been stated in your answers?

Mr. Rosenberg: No, I am asking him to explain. [876]

Mr. Bennett: Why they were made?

Mr. Rosenberg: Yes.

Mr. Bennett: That is different.

Q. (By Mr. Rosenberg): First, Mr. Watt, will you tell us what changes, if any, have been made in the method of allocating general overhead?

Mr. Bennett: Isn't that covered by your answer to the interrogatories?

(Testimony of David Watt.)

Mr. Rosenberg: I would like him to refresh his memory, because I am not sure his answer was correct, Mr. Bennett.

Mr. Bennett: What answer?

Mr. Rosenberg: The one he just gave.

Mr. Bennett: In what particular?

Q. (By Mr. Rosenberg): Will you read the answer that was given?

A. "Prior to January 1st——"

Mr. Rosenberg: No, I mean I would like to have the reporter read the last answer of the witness.

(Record read.)

Q. (By Mr. Rosenberg): What was the reason for making that change in spreading overhead?

A. It was a refinement in accounting, as far as we were concerned.

Q. Was that change made uniformly throughout the plant or was it only made as to gypsum?

A. Throughout the plant.

Q. During what period of time had you been allocating overhead [877] on the basis of supervision and operating labor?

A. January 1, 1944, to January 1, 1946.

Q. At all times prior to that and subsequent to that period you have used what as the basis for allocating?

A. Direct labor, operating and repair combined.

Q. Mr. Watt, have you prepared a tabulation showing what the cost of producing gypsum would have been in accordance with the books and rec-

(Testimony of David Watt.)

ords of Westvaco Chlorine Products Corporation for the period from July 1, 1945, to June 30, 1946, employing the same accounting methods in that period as were employed in the prior period, or are you having such a statement prepared?

A. I am having such a statement prepared.

Q. When do you expect to have that?

A. I hope I will have it Friday morning. I do not know if the office is working today.

The Court: I think this is a good place to pause and adjourn for the Christmas season, gentlemen. I want to wish all of you the blessings of the season, and I hope at this time next year we will have the hope and peace in years to come, of which this year was not very productive.

Mr. Rosenberg: I am sure we all feel the same about that.

Q. (By the Court): You will have your data Friday morning?

A. I hope so, your Honor. [878]

The Court: This is not an oration, gentlemen. I would like you to think about it. I think the crux of this case is with this witness on the stand. I propose to give you all the time you want. At times I get a little impatient. That is not with the thought of doing anyone an injustice.

(Discussion between court and counsel.)

The Court: With that we will adjourn until Friday morning at ten o'clock.

Mr. Rosenberg: Thank you, your Honor. I am sure we all wish you a very Merry Christmas and

(Testimony of David Watt.)

hope we will have the privilege of exchanging those greetings for many years to come.

Mr. Bennett: Yes, your Honor.

The Court: I hope when we get through here I won't disappoint anyone.

(Thereupon an adjournment was taken until Friday, Dec. 26, 1947, at 10:00 o'clock a.m.)

Friday, December 26, 1947, 10:00 o'clock a.m.

The Clerk: Pacific Portland Cement Company vs. Westvaco Chlorine Products Company.

Mr. Rosenberg: Ready.

Mr. Bennett: Ready.

DAVID WATT,

recalled as a witness on behalf of defendant; previously sworn

Direct Examination (resumed)

Q. (Mr. Rosenberg): Mr. Watt, have you some figures with you showing the amount of gypsum produced and the amount of magnesia produced and the quantities of sales of those two products during certain years that this contract has been in effect?

A. I do.

Q. Do you have them with you?

A. They are in my briefcase.

Q. What years does that information cover, Mr. Watt?

A. It covers from the year 1937 up to June 30, 1946.

(Testimony of David Watt.)

Q. Will you state the quantities of gypsum and magnesia produced during those periods and the quantities of magnesia produced and sold during that period of time?

Mr. Bennett: The witness is referring to some document before the question is asked, and I am precluding from making [880] an objection. May I look at this document?

Mr. Rosenberg: Yes.

Q. From what source was that information taken, Mr. Watt?

A. From the books of the company.

Q. At the Newark plant?

A. At the Newark plant, yes, sir.

Mr. Bennett: I don't know, your Honor, the precise purpose counsel has in this, but it presents again a somewhat difficult practical problem that is presented to us. I have indicated heretofore that we do not wish to interpose objections, particularly any that are technical in nature which will have the effect of unduly prolonging the case, or making difficult or tedious its presentation. At the same time we feel that we should not waive the best evidence rule to the extent that we are bound by figures that may be presented by witnesses here where we do not have the opportunity adequately to test them.

Perhaps I have not made my point clear. If I knew more definitely the purpose of this evidence, it might aid us in waiving the objection or making it. I told your Honor at the start that we would

(Testimony of David Watt.)

try to present this case and conduct the trial of it so far as we were concerned on our side, to present to your Honor the basic principles of law and fact, trusting that if it became necessary to get down to actual figures—— [881]

The Court: Indicate the purpose of this testimony.

Mr. Rosenberg: Yes, your Honor. There has been mention throughout the trial of the relative quantities of magnesium and gypsum produced. I asked Mr. Watt to take from the records of the company the quantities of the two products produced. Now, it may be that this is not the best evidence. However, they are figures that the witness states under oath were taken directly from the books of the plant, and as the court can appreciate, and Mr. Bennett also, it would just be a practicable impossibility for us to bring all of the records into court here because we just could not continue to operate over there.

Is there any question about the fact that these figures have been honestly taken from the records, Mr. Bennett?

Mr. Bennett: Mr. Rosenberg, I always hate to be in a position of questioning one's honesty.

The Court: It may come in subject to correction.

Mr. Bennett: That perhaps would be the most expeditious way of doing this.

The Court: If there are any corrections to be noted, that may be done later.

(Testimony of David Watt.)

Mr. Bennett: We have noted, as your Honor knows, corrections that have been made by the defendant, himself, on original figures, on claims, for example, and I presume they are errors, and if your Honor will admit this subject to our right to verify or correct it, then I will not make objection. [882] This witness, as well as preceding witnesses produced by you, refer to the magnesia, itself. Now, there have been numerous other products produced. Is it your contention under the title "Magnesia" that that involves all of the other products produced in this process during the years in question?

Q. (Mr. Rosenberg): Does it, Mr. Watt?

A. Pardon me?

Q. On magnesia produced, does that include all magnesia products produced? A. Yes.

Mr. Bennett: And no other products?

Q. (Mr. Rosenberg): Are there any other magnesia products that are not contained in this tabulation?

A. These are all magnesia products.

Mr. Bennett: The evidence also shows that until very recently you produced bromine from the very beginning, and nothing is shown from these figures as to the quantity of bromine produced.

Q. (The Court): Do you know that?

The Witness: I don't know exactly year to year, but we can get those figures if necessary.

The Court: You may proceed, counsel.

Mr. Rosenberg: Do you want the bromine figures?

(Testimony of David Watt.)

Mr. Bennett: Well, bromine and lime. I understand you produced and sold a lot of lime down there.

The Court: As I follow this testimony and the purpose of [883] it, you want to prove the amount of magnesia and gypsum produced?

Mr. Rosenberg: That's right, your Honor.

The Court: Does that have any relation to this bromine production?

Mr. Rosenberg: That is up to Mr. Bennett. If I understood plaintiff's position, their position is that the gypsum is produced incidental to the magnesia. I have not heard any mention of bromine, but we have not any objection at all to providing those figures.

Mr. Bennett: You may offer those figures for some purpose of showing relative productions at your plant, and I thought if that was the purpose that we should have all of them.

The Court: We have been discussing products and by-products and what-not, and also there is testimony already in the record in relation to the amount of magnesium produced and the amount of gypsum produced. Now, they went to the books, and I think without stretching the testimony out it is well for us to have the amounts.

Q. (Mr. Rosenberg): Will you state by periods the amount of magnesia produced in tons, the amount of gypsum produced in tons; and for the same period the amount of magnesia sold and the amount of gypsum sold?

(Testimony of David Watt.)

A. In the year 1937, magnesia produced—212 tons, gypsum produced—376 tons. Magnesia sold—54, gypsum sold—195 tons. [884]

In the year 1938, magnesia produced—7017 tons, gypsum produced—10,948 tons. Magnesia sold—5143; gypsum sold—9301.

The period July 1, 1939, to June 30, 1940, magnesia produced—19,085; gypsum produced—27,685. Magnesia sold—15,586; gypsum sold 26,776.

Period July 1, 1940, to June 30, 1941, magnesia produced—23,882; gypsum produced—32,000 even. Magnesia sold—13,831; gypsum sold 31,164.

The year 1942, magnesia produced—34,077; gypsum produced 31,826. Magnesia sold—26,929; gypsum sold—30,818.

The year 1943, magnesia produced—37,671; gypsum produced 24,431. Magnesia sold—28,727; gypsum sold—23,848.

Period July 1, 1944, to June 30, 1945, magnesia produced—41,004, gypsum produced—33,420. Magnesia sold—39,305; gypsum sold—32,582.

Period July 1, 1945, to June 30, 1946, magnesia produced—42,694; gypsum produced 36,658. Magnesia sold—40,032; gypsum sold—34,930.

Mr. Bennett: Counsel, are you offering that document in evidence?

Mr. Rosenberg: No, I am not.

Mr. Bennett: I wonder if it would not be at least convenient to both court and counsel if it would be marked for identification. We may want to refer to those figures, counsel, [885] and it may

(Testimony of David Watt.)

be more convenient to refer to them by the document than to go back through the reporter's transcript.

Mr. Rosenberg: I will say, Mr. Bennett, I can have copies made so you can have a copy and I can have a copy as well.

Mr. Bennett: Is there any objection to offering that for identification?

Mr. Rosenberg: No, but I want to take the document out so as to be able to make copies.

Mr. Bennett: Yes.

(The document was marked Defendant's Exhibit J For Identification.)

Mr. Rosenberg: Well, rather than have it marked for identification I will offer it in evidence.

The Court: It may be admitted in evidence.

(Defendant's Exhibit J For Identification was thereupon admitted in evidence.)

DEFENDANT'S EXHIBIT J

	July 1, 1945	July 1, 1944	Year	Year
	June 30, 1946	June 30, 1945	1943	1942
Magnesia Produced	tons 42,694	41,004	37,671	34,077
Gypsum Produced	tons 36,658	33,420	24,431	31,826
Magnesia Sold	tons 40,032	39,305	28,727	26,929
Gypsum Sold	tons 34,930	32,582	23,848	30,818
	July 1, 1940	July 1, 1939	Year	Year
	June 30, 1941	June 30, 1938	1938	1937
Magnesia Produced	tons 23,882	19,085	7,017	212
Gypsum Produced	tons 32,000	27,685	10,943	376
Magnesia Sold	tons 13,831	15,586	5,143	54
Gypsum Sold	tons 31,164	26,776	9,301	195

(Testimony of David Watt.)

Mr. Bennett: That is an admission in evidence subject to the same reservation that I have offered before, your Honor?

The Court: Yes, subject to any correction.

Q. (Mr. Rosenberg): Mr. Watt, there has been some testimony about an occasion in October, 1946, when Mr. Bannard, of Pacific Portland Cement Company, came to the Newark plant to inspect the record pertaining to the notice of increase that had been given by Westvaco to Pacific at that time. Do you recall that? [S86]

A. I do.

Q. Did you have discussions with Mr. Bannard at that time?

A. I did.

Q. What occurred on that occasion with reference to inspection of records or figures? How long did Mr. Bannard spend at the plant on that occasion?

A. I would say about three days.

The Court: Fix the time.

Q. (Mr. Rosenberg): When was that, Mr. Watt?

A. I believe it was September, 1946—September or October, 1946.

Q. What did Mr. Bannard do during those three days?

Mr. Bennett: Was this witness present?

Q. (Mr. Rosenberg): Were you present with Mr. Bannard at that time?

A. All the time.

Q. What did Mr. Bannard do on that occasion?

A. Made a general audit for all the charges for the two periods under review.

(Testimony of David Watt.)

Q. Those were what periods?

A. July 1, 1944, to June 30, 1945, and June 1, 1945, to June 30, 1946.

Q. Did you have any conversation with Mr. Bannard relating to the subject of overhead charge to gypsum?

A. Well, I did, yes. [887]

Q. Did Mr. Bannard raise any question as to the propriety of including general overhead?

A. No, he didn't.

Mr. Bennett: Now, Counsel, I have been talking to my client here and after this question was asked perhaps I should have made an objection to the question, although it may go to the weight rather than admissibility. The evidence so far shows Mr. Bannard was not authorized to negotiate with the defendant, that all his function included was to go down there and get the facts and figures.

The Court: For whom?

Mr. Bennett: What was that?

The Court: For whom?

Mr. Bennett: For Pacific.

The Court: Then they are bound by that.

Mr. Bennett: Mr. Bannard's function was not to permit Pacific——

The Court: No, but to get such information as they wished.

Mr. Bennett: That's right, but the point of whether or not he raised objection to overhead items——

The Court: Was anything said in relation to overhead?

(Testimony of David Watt.)

The Witness: He did check the overhead.

The Court: All right, he checked the overhead. Develop the facts whatever they may be.

Mr. Bennett: What I wanted to object to was the question [888] as to whether or not Mr. Bannard raised any objection to including overhead, as incompetent, irrelevant, and immaterial.

Mr. Rosenberg: I don't know—Mr. Flick said he was a certified public accountant and sent him down to use his own good judgment.

Mr. Bennett: I think Mr. Flick's statement was that he should use his own judgment as to how far he should go to get the facts.

Q. (Mr. Rosenberg): Now, Mr. Watt, I will refer your attention to Plaintiff's Exhibit 17, which is Exhibit E, to defendant's answer to the interrogatories, and direct your attention to the item of water, for which there appears to be no charge in 1942, and a charge of 1 cent per ton in 1943. Can you explain why it is that there was no charge for water in 1942?

A. Without going back to the actual statement for these two years, I would say that the charge for water for 1942 was so small that it made no difference in the unit cost. In other words, there was not any unit cost reflected, because the tonnage was so high and the water charge was so small—that is, in actual dollars.

Q. Can you state, Mr. Watt, from the fact that no charge appears in 1942 and a charge of 1 cent

(Testimony of David Watt.)

appears in 1943, would that result from any change in accounting methods or practice?

A. No, it did not.

Mr. Bennett: Are we talking now about inter-departmental [889] water or direct water?

Mr. Rosenberg: Direct.

Q. Referring your attention to Plaintiff's Exhibit 15, which is Exhibit F to the answers to the interrogatories under the account Fuel Oil, there appears to be a charge of 1 cent per ton in cost measured for the period from July 1, 1945, to June 30, 1946. and no charge for the same item in the preceding 12-month period. Can you explain how that occurred?

A. Again, without going back to the actual statements for this, I would say during the period July 1, 1945, to June 30, 1946, that at sometime during that period the gas was cut off and we had to go onto fuel oil.

Q. Do you know that to be a fact?

A. I don't know it to be a fact, but I would say that is what it is. I would have to check the records to find out if that is so.

Mr. Bennett: Rather than take up the time of the court, here, and require me to make a motion to strike that, had we not better defer detail matter of this kind on which the witness has no knowledge?

Mr. Rosenberg: I thought he had checked it, Mr. Bennett.

Mr. Bennett: I move to strike the answer.

(Testimony of David Watt.)

Mr. Rosenberg: Very well. I thought he had checked it, Mr. Bennett. That was probably my fault.

Mr. Bennett: In that connection we have not questioned or [890] objected as to the actual figures involved, either for this item of direct water, and without any waiver of right to object in future years——

The Court: Or the oil?

Mr. Bennett: Yes, or the oil, so far as these past periods are concerned. We thought that was made clear by our testimony.

Q. (Mr. Rosenberg): Referring your attention again to Exhibit 15 and the item Sulphuric acid, which appears as 35 cents for the period June 1, 1945, to June 30, 1946, and no charge for the preceding 12-month period—(Addressing Mr. Bennett): It has been stated in the record that item has been reduced from 35 cents to 23 cents, is that right, Mr. Bennett?

Mr. Bennett: Yes, since the original demand for price increase, and after the filing of our interrogatories you reduced the claim charge of sulphuric acid from 35 cents to 23 cents.

Q. (Mr. Rosenberg): Can you explain the reason for that reduction in that item from 35 to 23 cents?

A. We found we made an accounting error.

Q. And what was the nature of the accounting error?

A. That during the time the bromine towers were working, one of the accountants had missed

(Testimony of David Watt.)

up on an item and charged sulphuric to gypsum instead of towers.

Q. What has been the practice over the years in the plant with reference to the charge for sulphuric?

A. When the bromine towers were working, the sulphuric is [891] always charged to the bromine department.

Q. And during the time the bromine towers were working, was any charge for sulphuric made to gypsum? A. No.

Q. Has that practice been constant throughout the years? A. It has.

Q. What occurred to cause the sulphuric acid to be changed to gypsum?

A. In September of 1945—August or September, 1945, the towers closed down. The bromine towers closed down.

Q. You mean by that, that they discontinued the production of bromine over at the plant?

A. That's correct.

Q. Was there any production of bromine from the time that the bromine towers were closed down in September, of 1945, until June 30, of 1946?

A. There was.

Q. There was bromine produced? A. Yes.

Q. When?

A. Sometime in the beginning of 1946. That is why we discovered the 12-cent error.

Q. During what period of time—

The Court: Just a moment.

(Testimony of David Watt.)

Mr. Rosenberg: Yes. [892]

Q. (The Court): Explain that further, if you will.

A. (The Witness): When the bromine towers discontinued in September of 1945, before that we were charging sulphuric to the bromine. After they closed down we were charging sulphuric to gypsum. In the early months of 1946 the bromine towers operated, but one of the accountants kept on charging the sulphuric to gypsum. When we found that out we went back and corrected it and charged the sulphuric to the towers when they were operating, which resulted in a reduction of 12 cents of sulphuric to gypsum.

The Court: I understand. Very well, proceed, counsel.

Q. (Mr. Rosenberg): At any time during the operation of the plant at Newark has any of the sulphuric acid been charged to magnesia?

A. Never.

Q. With reference to the charges for depreciation, insurance, and taxes, has there been any change over the years in the methods employed in charging those charges to the various products produced? A. No, sir.

Q. With reference to the bittern, what has been the method followed at the plant in accounting for the bittern that is in the bromine, gypsum and magnesia produced?

A. It was allocated to the three products on an arbitrary basis. [893]

(Testimony of David Watt.)

Q. Will you explain what you mean by an arbitrary basis?

A. Well, the best basis that we could think of.

Q. As a matter of judgment?

A. As a matter of judgment, yes.

Q. Has there been any change in the basic method of charging the bittern to those products throughout the years over there? A. No.

Q. I believe when Mr. Flick was on the stand he mentioned the fact that you have a very beautiful plant over there at Newark, and there is landscaping and gardening, and that is included in overhead. What is the situation in that regard, Mr. Watt? A. Landscaping?

Q. Yes.

Mr. Bennett: Now, just a minute.

Mr. Rosenberg (Continuing): Q. Shrubbery, trees and grass and things of that character. What is the acreage of the plant, Mr. Watt?

Mr. Bennett: You mean the plant, or the whole ground, including your holding ponds?

The Court: Proceed, gentlemen.

The Witness: I believe it is 26 acres.

Mr. Rosenberg: Q. Is any substantial portion of that cultivated or improved, or beautified?

A. Not other than our garden. [894]

Q. How big is that?

A. I would say about a quarter to half an acre—I wouldn't know.

Q. Have you figured how much the charge to gypsum per year is for that item?

(Testimony of David Watt.)

A. Say about a dollar or two dollars a year.

Mr. Bennett: A dollar a year or a dollar a ton?

The Witness: No, not a dollar a ton, Mr. Bennett. We could really landscape it at that rate.

Mr. Rosenberg: Q. Let me ask you this, Mr. Watt: Based upon your experience and your accounting knowledge, do you consider that it is proper to include in the cost of production of gypsum the plant and—a portion of the plant overhead? A. I do.

Q. Can you state whether or not that is the practice that has been employed at Newark with reference to the products that are produced there over the years? A. It has.

Q. Has there been any change in that respect during the period that you have been there?

A. No.

Q. Is there any distinction made with reference to the accounting practices employed in the case of gypsum as compared to the other products produced there? A. There is not.

Q. Now, directing your attention to Plaintiff's Exhibit 18, and under the item "Supervision" appearing on the summary sheet, I note that there is a charge of 4 cents per ton in the period July 1, '45 to June 30, '46, and the charge of 4 cents per ton during the preceding 12 months' period, and in prior periods there do not appear to be any charges under that category. Can [895] you

(Testimony of David Watt.)

tell me whether or not supervision in the prior years was charged in some other account?

A. It was. It was charged as an overhead account.

Q. Does that appear in those work sheets?

A. (Referring to exhibit) Note, supervision—

Q. That appears in the work sheet under “Overhead and General Plant Expense”?

A. Yes, it does.

Q. And is designated “Newark Supervision”?

A. Yes.

Q. Now, directing your attention to the third sheet in this group, designated “Overhead and General Plant Expense,” there are a number of items that are designated “West Coast items,” “West Coast general expense, West Coast general supervision,” and so forth. Will you explain what that designation connotes, “West Coast”?

A. Well, I would say that they pertain to the West Coast operations.

Q. What are these West Coast operations?

A. The Newark plant.

Q. And any other plant?

A. Chula Vista.

Q. And any other?

A. Right now the Hollister mine.

Q. Now, as to those West Coast expenses, are they all charged [896] to the Newark plant, or only a portion of them?

A. Only a portion of them.

Q. And is it—the items that appear on that sheet as West Coast, is that only a portion that is

(Testimony of David Watt.)

allocated to the Newark plant or is that the entire West Coast expense? A. This portion—

Mr. Bennett: Just a moment. Here again I don't want to interpose technical objections, but there is a question as to whether this witness is technically qualified on this field of testimony. As I understand the document, these West Coast charges are like the New York office charges, an assessment to the several plants for a certain share of the West Coast overhead.

Now, counsel, do you want to Court to understand that this witness is qualified to testify as to what his company has done in allocating or assigning the West Coast overhead and New York overhead? If he is, why, maybe his testimony is admissible.

Mr. Rosenberg: Q. Let us take the item of West Coast General Expense; what is that?

A. That is a portion of West Coast general expense allocated to the Newark overhead.

Q. Where is that allocation made?

A. We make that at Newark.

Q. You make that at Newark? [897]

A. Yes.

Q. And is that true as to all of the items that are designated there under the caption "West Coast"?

A. It is true to all overhead items, whether West Coast or other.

Q. Those items that are designated as West Coast expense, whether they are of one kind or

(Testimony of David Watt.)

another, do those items represent the entire West Coast expense under the various categories or only the portion of those items that are allocated to the Newark plant?

Mr. Bennett: Just a moment, just one minute here, your Honor. There is another objection I want to make here to save our position and keep it clear for the record, as well as your Honor's consideration. When these documents and things that were prepared by the plaintiff were admitted in evidence, they were admitted solely for the purpose of showing what the defendant claims were costs and expenses. Now, without repeating the details of whether we were or not allowed to verify figures, we have taken this position consistently during the trial, your Honor, and I don't want to shift from it, their merely furnishing these figures and their discussion by the witness is not the best evidence of actually what occurred, and we don't want to be bound by the ipse dixit or declaration of this witness or other witnesses, no matter how honest he may be, because of several factors. We would otherwise be bound by facts and figures in [898] this case that might ultimately reflect the money judgment the Court would render, and so far as those issues are concerned, without us being privileged to verify the figures, and I think that the purpose is manifestly important for another reason; it has already been developed by the defendant's own testimony that they made errors in their computations, and we don't want to have

(Testimony of David Watt.)

this indirect way for the Court to accept figures as binding upon the plaintiffs—

The Court: I thought we had agreed that they would go in subject to any correction here in the future at any time. If there is any doubt about any figures, I wouldn't want anybody to be bound by them.

Mr. Bennett: Well, that would, of course, be the most expeditious way of handling it. I am anxious to do that. My only purpose, your Honor, is to save our position that we are not bound so far as the money judgment in this case is concerned by mere figures that defendant comes in here and offers from the witness stand in this fashion.

The Court: Very well, then, let us take another step. You indicate that your objection goes to the best evidence rule. What do you have in mind?

Mr. Bennett: Of course, under the best evidence rule, you actually prove, and it is our theory the defendant must prove, these raises in claimed cost; they would have to prove it by appropriate evidence. For instance, we are dealing with West [899] Coast allocations.

The Court: Yes.

Mr. Bennett: Now, how this witness can say from the witness stand that this is the correct West Coast allocation is beyond me—

The Court: He didn't say it was correct. He indicated this was the allocation. Whether it is correct or not I will have to try and struggle with that.

(Testimony of David Watt.)

Mr. Bennett: The way Courts ordinarily do that is to require books and records that would show that so at the time of the trial we can cross examine.

The Court: You sent an expert down there and didn't see fit to follow it up. It is well to keep in mind that on account of the nature of the case and all, and its presentation, and resulting from bookkeeping and the method of accounting, when both sides were in the position they were, to have an expert, you weren't concerned about expense, but I have no control of that item in the preparation of the case. Now, if we did have the books here and those that kept them, I don't know whether we would get through in the next three weeks.

Mr. Bennett: Well, it is possible we would not, and it is a practical matter. I have my objection as I have made it, and perhaps so far as this particular case is concerned as to monies due or not due up to date, maybe we can go on and expedite the trial, but—expedite the trial by admitting this [900] evidence subject to correction. However, I want your Honor to see that it is a serious matter, this question of verifying figures, because if we don't have that right then any sort of figures can be submitted and bases, perhaps with honest purpose, but inspired by partisan spirit, and it would deny us the very essence of the contract.

The Court: Is there anyone in your plant who knows any more about these figures than you do?

The Witness: No, I don't believe so.

(Testimony of David Watt.)

The Court: Proceed with this case.

Mr. Bennett: It is my understanding that your Honor is admitting this subject to correction.

The Court: Yes, subject to correction, any correction at any time.

Mr. Bennett: If that is required.

Mr. Rosenberg: Q. Now, Mr. Watt, referring to Plaintiff's Exhibit 17, was that prepared by you under your direction?

A. No, it was not.

Q. Do you know who it was—

A. Pardon me, do you mean this actual sheet?

Q. Yes. A. Oh, yes, it was.

Q. After checking the records at the plant?

A. Yes.

Q. In your opinion, does that sheet correctly portray and [901] reflect the cost of production of gypsum for the years that are designated on the sheet? A. It does.

Mr. Bennett: I object to that as calling for the conclusion and opinion of the witness, incompetent, and not the best evidence, your Honor.

The Court: Going back again, what is the best evidence?

Mr. Bennett: He has asked now the question as to whether this self-serving document they have presented represents the actual proper allocation of cost of gypsum. That is a terrifically broad question, as I understand it, and really putting the witness in your Honor's seat.

The Court: Read the question, Mr. Reporter.

(Testimony of David Watt.)

Mr. Rosenberg: When Mr. Bennett had witnesses on the stand, he took them item by item. I was trying to save time. I thought I could short-cut a little and ask if there were any exceptions and he could mention them and we could go into those items.

The Court: When he is subject to any cross examination, you wish to level at him, I don't see, keeping in mind what we are trying to do, that we can get at it any other way.

Mr. Bennett: If the question is deemed that that is the witness' claim as to the allocation, why. I will not object to that.

The Court: That is all he could do in any event. That is [902] all they are claiming. These figures they are presenting—if I am in error, I will stand corrected.

Mr. Rosenberg: That is our claim, and it is this witness' opinion as accountant for the firm, that those figures properly show the cost of production for the periods reflected.

The Court: Proceed.

A. It does.

Mr. Rosenberg: Q. Would you say the same as to Plaintiff's Exhibit No. 15 covering the period from July 1, 1945 to June 30, 1946 and the preceding 12 months' period? A. I would.

Mr. Bennett: I must make the same objection.

The Witness: I would.

The Court: Let the record note the objection. I will overrule the objection.

(Testimony of David Watt.)

Mr. Rosenberg: I have no further questions—
Just one second. Mr. Reporter, you got an answer
to that question, did you?

The Reporter: Yes, I did.

Mr. Bennett: Have you finished, Mr. Rosen-
berg?

Mr. Rosenberg: Yes.

The Court: We will take a few minutes' recess.

(Recess.)

Cross Examination

Mr. Bennett: Q. Mr. Watt, other than the
experience you [903] have had in the setting up
of this cost accounting system for Westvaco, what
other experience have you had with reference to
setting up and determining cost accountings as far
as the allocation of costs?

A. I don't quite understand that, Mr. Bennett.
You said setting up the cost accounting for West-
vaco?

Q. Until you went to Westvaco, you had not
had the responsibility of setting up or determining
cost accounting for allocation of various costs?

A. Oh, definitely. I had that experience in
Africa.

Q. In Africa? A. Yes.

Q. That had to do with what kind of business?

A. Palm oil reduction.

Q. What? A. Palm oil reduction.

Q. Palm oil reduction? A. Yes.

Q. That involved the manufacture of a by-
product or byproducts? A. No, it didn't.

(Testimony of David Watt.)

Q. The products there were oil made from the palm and cocoanut? A. That's correct.

Q. That's right. How long were you so engaged with that palm oil business? A. Ten years.

Q. Now, you testified on your direct examination that from time to time you made changes in your accounting method so far as the allocation of direct—or the allocation of indirect charges was concerned, one example being the shift from the allocating of the supervisory or overhead phase of your shipping department from the value basis to a tonnage basis, and in your answer to the interrogatories 10E you described a number of other changes in accounting methods so far as allocations were concerned during the period from 1937 on until and including 1946, and you stated the end of your answer to paragraph 10E of plaintiff's interrogatories, "The above changes were brought about upon the advice of competent accountants for the purpose of improving the bookkeeping and accounting records of defendant as related to all products produced by defendant, including gypsum, and to accomplish uniformity of accounting practices between various units of defendant company."

Were these changes made pursuant to advice of outside accountants or did you refer to yourself?

A. No, they were usually made by our New York office.

Q. These changes, then, were made by the New York office rather than yourself?

(Testimony of David Watt.)

A. Oh, definitely, yes.

Q. For example, this change in 194 — for instance, this change that you say was made in June 1945 where miscellaneous shipping expense was changed and allocated to gypsum on a tonnage [905] basis, whereas before it was allocated on a value basis, was that change dictated or directed by your New York office? A. It was not.

Q. That was a change that you, yourself, undertook to make? A. That's correct.

Q. Then when you referred to the statement that the changes were brought about by the advice of competent accountants, you meant you, yourself, as the competent accountant?

A. I believe so in that case.

Mr. Rosenberg: He didn't prepare those answers to the interrogatories.

Mr. Bennett: The interrogatories were signed and verified by Mr. Watt and he testified, as I understood, on Wednesday that he prepared the answers, himself. If I am wrong, why, I will be pleased to correct it, but the witness—

Mr. Rosenberg: He didn't say that.

The Court: What is the fact.

The Witness: What is the question?

The Court: In relation to those interrogatories, did you prepare them?

A. I assisted in that.

Q. You assisted in that? A. Yes, sir.

Mr. Bennett: And you saw them after they were prepared, did you not?

(Testimony of David Watt.)

A. I beg your pardon?

Q. You saw them after they were prepared?

A. Yes.

Q. You signed them, did you not? [906]

A. I did.

Q. And when you signed them they represented your views and opinion as to what they contained, did they not?

A. I would say so, yes.

Q. This change in 1945 as to the method of allocating miscellaneous or indirect shipping expense was made solely because of your recommendation or decision? A. That change, yes.

Q. Now, the first change you mentioned in your answer to interrogatories, and referring specifically to paragraph 10-E, is as follows:

“Prior to January 1, 1944, all overhead expense was allocated on the basis of operating labor and repair labor expense. Commencing January 1, 1944, and until January 1, 1946, general overhead expense was allocated on a combined supervision and operating labor basis.”

Was that decision to make that change yours, or the New York office's?

A. The New York office.

Q. You received specific instructions in writing to do that? A. No.

Q. How were those instructions communicated to you?

A. Usually by telephone or by someone out on the post from the New York office.

(Testimony of David Watt.)

Q. Do you specifically remember receiving instructions from the [907] New York office?

A. I do not.

Q. How do you know that change was made on instructions from New York office?

A. Mr. Cuneo was in the office at that time.

Q. But you were in charge at that time of the office?

A. No, I was the assistant office manager.

Q. You were the assistant in charge of accounting?

A. I was assistant to Mr. Cuneo, who was in charge of accounting.

Q. Then you don't know, except what Mr. Cuneo, told you, as to instructions to make a particular change—

A. I know he got those instructions; otherwise, the change would not have been made.

Q. How do you know he got those instructions? Did he tell you, or did someone else tell you?

A. No, I am quite sure he would have told me.

Q. But you have no distinct recollection on that?

A. No, I haven't.

Q. Mr. Cuneo might have made the change for his own purpose?

A. No, he didn't.

Q. How do you know that?

A. Because we don't change like that.

Q. Well, you changed your shipping?

A. Yes, but that was not an over-all change like overhead. [908]

(Testimony of David Watt.)

Q. But your statement about this change commencing January 1, 1944 to January 1, 1946 of allocating general overhead expense on a combined supervision and operating labor basis made pursuant to New York office instruction is merely a conjecture and opinion on your part?

A. All right, yes.

Q. The change in maintenance and engineering cost, allocated on a repair basis, was made when? Do you have a copy of this? A. No, I don't.

Q. Maybe I can supply you with one. You can turn to page 5, Mr. Watt. A. Yes.

Q. Look at line 13; it says, "Maintenance and engineering costs were allocated on a labor repair basis." A. Yes.

Q. When did that commence?

A. At the same time, January 1, 1944.

Q. Prior to that time how were maintenance and engineering costs allocated?

A. On a combined operating and repair labor basis.

Q. Do you know why that change was made?

A. I believe it was made pursuant with every other change at the same time.

Q. You just assume that?

A. I know that, too, that it was made then.

Q. You know it was made, but you don't definitely know of your own knowledge that it was made pursuant to any express instructions received from the New York office? A. No.

Q. You, yourself, did not decide to make that change? A. No.

(Testimony of David Watt.)

Q. The next statement is, "Process control and control laboratory costs were allocated on a direct basis with the balance of the costs of these two departments pro-rated over the direct allocation."

Was that method commenced on January 1, 1944? A. Yes, sir.

Q. Prior to that time how was that allocation made?

A. On an operating and repair labor basis.

Q. Do you know the specific reason why that change was made on January 1, 1944?

A. I do not.

Q. The next statement is, "Commencing January 1, 1946 and during the period from that date to and including June 30, 1946, the same procedure was followed with the exception that general overhead was allocated on a combined operating and repair labor basis." In other words, commencing January 1, 1946, you went back to the method and basis of allocation that you had followed prior to January 1, 1944? A. That's correct. [910]

Q. Do you know why that change was made?

A. Made the change on January 1, 1946?

Q. Yes.

A. That was made because of New York office instructions.

Q. Did you receive, yourself, specific instructions from the New York office? A. Yes.

Q. When did you receive those instructions?

A. I believe it was in the middle of 1945, June or July of 1945.

(Testimony of David Watt.)

Q. What was the form of those instructions, written or oral?

A. No, Mr. Cuneo was out on a trip from New York.

A. And he asked us to go back to this basis again.

Q. Mr. Cuneo at that time had been transferred to the New York office? A. Yes.

Q. Did he tell you why he wanted you to go back to that former basis of allocating cost?

A. Yes, he did. He said he wanted all locations on the same basis.

Q. All locations? A. Yes.

The Court: What do you mean by that?

A. Our other plants throughout the country.

The Court: To the other plants throughout the country, he said.

Mr. Bennett: Yes.

Q. He told you at the same time that this change that was put into effect at Newark on January 1, 1945, had developed novelties or differences in allocation at the Newark plant that were not in accord with what the company wanted for its uniform policy throughout the country?

A. No, he didn't say that.

Q. Well, it was the fact?

A. Well, I don't know. He just told us to change to this basis.

Q. And the change which was effected January 1, 1946, was according to your instructions from Mr. Cuneo to put the method of allocating costs

(Testimony of David Watt.)

here on a uniform basis with all of the other plants of the company throughout the country?

A. That's correct.

Q. Did you on January 1, 1946, make a further change on the basis of allocating miscellaneous shipping expense to gypsum? A. No.

Q. In other words, you continued, despite Mr. Cuneo's instructions which you received you say sometime in 1945, you continued after January 1, 1946, to allocate miscellaneous shipping expense to gypsum on a tonnage basis rather than the former basis of value? A. That's correct. [912]

Q. Now, up until June of 1946 and all during the period that this contract that is in suit for the sale of gypsum by your company to Pacific, miscellaneous shipping expense, if any, which was allocated to gypsum according to your method had always been allocated on a value basis, had it not?

A. Yes, it had.

Q. Now, Mr. Watt, I want to ask you in the next few questions something more in detail about this change of allocating miscellaneous shipping expense to gypsum, from the dollar sales basis to tonnage. In addition to the gypsum that your company has sold to Pacific Portland Cement Company, the plaintiff in this case, you also produce gypsum for pharmaceutical, chemical and scientific purposes which you do not sell to Pacific, do you not? A. That is correct.

Q. That tonnage approximates 4000 tons per year? A. About that.

(Testimony of David Watt.)

Q. Or approximately anywhere from one-fourth to one-fifth or one-sixth of that which you sell to Pacific? A. Correct.

Q. That particular gypsum is handled in a different way than the gypsum which is sold to Pacific, is it not? A. It is.

Q. That gypsum is further refined and packed and shipped in different forms than the gypsum which is shipped in carloads to [913] Pacific?

A. It is.

Q. Do you know the type package that some of that gypsum that you sell for scientific, chemical, or pharmaceutical purposes takes?

A. In bags?

Q. Yes. A. Yes.

Q. That is sold in small lots to people all over the United States, isn't it?

A. Well, about two or three customers at the most, I would say.

Q. That is not handled in bulk, however?

A. No.

Q. And it takes different forms of the product, according to your understanding?

A. How do you mean, different forms, Mr. Bennett?

Q. I mean, it is not the same gypsum that is shipped to Pacific Portland Cement Company; it is further refined and further processed?

A. I believe so, yes.

Q. The gypsum that is shipped to Pacific Portland Cement Company is the gypsum that has been

(Testimony of David Watt.)

dried and ground in the drying and grinding part of your plant and then delivered the bulk in the warehouse, and from the warehouse is pumped by a pneumatic pipe system right into the box cars or open cars [914] in which it is shipped, isn't that so? A. That's so.

Q. That practice of handling the gypsum that is sold to Pacific Portland Cement Company has continued in the same fashion and in the same manner ever since this contract has been in force?

A. That's right.

Q. But the gypsum that you manufacture and sell normally goes through a manufacturing process, which is packed in bags and containers and is shipped out to at least several different customers? A. That is correct.

Q. I suppose that gypsum has to meet certain specifications and character requirements, does it not?

A. That I don't know, Mr. Bennett.

Q. Skipping for a moment the gypsum and going to the magnesia products, in addition to producing simple magnesium oxide you produce down there various and sundry derivatives of that product, do you not? A. Derivatives?

Q. Well, perhaps that is an inapt term, but there has been some evidence that there are different types and characters of magnesium products produced. A. Yes.

Q. You have the general product magnesia oxide which is used as fire-retardant and other

(Testimony of David Watt.)

purposes, and you have other magnesia [915] products which are produced, manufactured and refined as your plant at Newark? A. That's correct.

Q. Do you recall the various and sundry types and characters of those magnesia products?

A. I don't. I might know a few of the types, but not the character.

Q. Well, state them here, please.

A. Periclase S-90, Periclase S-93, Lightburn 2661, 2662, 2663, 2664, 2665, all unground; and the same products all ground—Remosil.

Q. Would you spell that, please?

A. R-e-m-o-s-i-l.

Q. What is Remosil?

A. It is a grade of magnesia product. I don't know what it is for. I believe Mr. Melhase testified as to what it was.

Q. Anything else that you now recall?

A. SMO—generally, that is the lot.

Q. When you are producing bromine down at this plant, as you did, with the exception of the period in 1944, is that handled and sold as just one single product, or are there different characters of that product or refinements thereof that are produced and sold?

The Court: Bromine?

Mr. Bennett: Yes. [916]

The Witness: A. Very little bromine sold at all. Most of the bromine manufactured goes into the making of ethylene dibromide.

Q. You make the ethylene dibromide at the Newark plant, too? A. Yes.

(Testimony of David Watt.)

Q. The bromine that comes from these bromine towers after the bittern with the sulphuric acid is added, is taken then to another part of your plant where this bromine product that you have mentioned is manufactured, with the addition of other chemicals, and so forth?

A. It is all in the same portion of the plant, bromine and dibromines are in the same plant.

Q. That bromine operation was one of the principal products produced at the plant while bromine was produced, wasn't it? A. Yes.

Q. And it is from a dollar sales value and quantity value? A. Yes, I would say so.

Q. How much weight by tons of bromine were produced during these years that you have shown, relative to the production of magnesium and gypsum?

A. I haven't the figures here. I could get them for you.

Q. Can they be obtained as readily as the figures you obtained here? A. Yes.

Q. I wish you would do that, Mr. Watt. How was the bromine [917] shipped out? In what form containers or packages was the bromine shipped out? A. You mean the dibromine?

Q. Yes. A. In tank cars.

Q. In tank cars? A. Yes.

Q. That was the only method in which that was shipped? A. Occasionally in containers.

Q. Small containers? A. Drums.

Q. Drums? A. Yes, special drums.

(Testimony of David Watt.)

Q. What about the production of lime in its various forms at your plant? Didn't this Newark plant produce considerable quantities of lime?

A. It did at one time, yes.

Q. Does it still produce any lime?

A. No, we are using dolomite now instead of lime.

Q. Are you using, according to your understanding, dolomite exclusively in this process of treating bittern water? A. I believe so, yes.

Q. As late as 1946, you were allocating certain expenses down there of an overhead or of an indirect nature to the production of lime, did you not? [918] A. Yes, that is true.

Q. According to Exhibit F, which you may turn to, attached to defendant's answer to plaintiff's interrogatories, according to your figures—(Addressing the court): Does your Honor have a copy of this?

The Court: I can follow you.

Mr. Bennett: Here is a copy.

Q. (Continuing): —sub-note 2 has dates with your percentage of allocation of so-called overhead items for the comparative period 1944 to 1946. According to Exhibit F you allocated 7.8 percent to gypsum, 3.1 percent to service accounts, and 9.4 percent to lime, 6.3 percent to ethylene dibromide, and 73.4 to magnesia. That would indicate, would it not, that even as late as 1946, from July 1, 1945, to June 30, 1946, your lime production was considered by you to be more important, and for that rea-

(Testimony of David Watt.)

son charged with a larger percentage of overhead cost than gypsum, isn't that correct?

A. No, I don't think that is quite correct, Mr. Bennett. You said "more important"? I don't see that, at all.

Q. You have charged against line 9.4 percent of overhead.

A. True, but that is based on labor. Labor to these departments has nothing to do with the importance.

Q. Well, certain of these items were based on labor and certain of the items of allocation were based on other methods, as you have just covered in your testimony before, pursuant [919] to these changes you made——

Mr. Rosenberg: You mean certain items of the overhead, Mr. Bennett?

Mr. Bennett: Yes.

Q. (Mr. Rosenberg): Do you understand it that way, Mr. Watt?

A. (The Witness): Pardon me?

Q. Are different methods used for allocating different overhead items?

A. No, not in general overhead.

Q. (Mr. Bennett): Do you mean by that that there has been no change through the years at all in the allocation of overhead items as to the basis?

A. No.

Q. There have been changes?

A. There have been changes, yes.

Q. That is what I understood, and counsel ques-

(Testimony of David Watt.)

tioned the correctness of my statement. Mr. Watt, there is more detail work required in handling your shipping department of this gypsum that is manufactured at your Newark plant and sold for scientific, pharmaceutical or chemical purposes to customers other than Pacific Portland that there is in the handling of the product out of the warehouse by pumping it in bulk into the cars, weight for weight, isn't there?

A. I don't think I am qualified to answer that, Mr. Bennett. [920] That would be for the production department, not for the accounting department.

Q. Well, I think it is more or less obvious from what you have already told us. By the way, magnesia and various of its products are packaged in relatively small packages?

A. No, we have all various sizes of packages.

Q. All various sizes of packages? A. Yes

Q. From small ones to regular gunny sacks?

A. Yes, and also bulk.

Q. Now, I am referring specifically to this change you put into effect on June 30, 1945, on allocating your miscellaneous shipping expense from a value basis to a tonnage basis. At that time what was the value of magnesia per ton? What were you selling it for? What was your quoted price?

A. We have so many different prices for the different products——

Q. Well, in bulk wasn't magnesia sold for approximately \$46 a ton?

(Testimony of David Watt.)

A. I wouldn't say that. We had all different prices.

Q. What were the prices you were selling your magnesia?

A. Off-hand I couldn't recall. I would have to refer to the books for that.

Q. You haven't any idea?

A. We have had some as low as \$45 and we have had some at \$46, and some higher than that.

Q. How high do some of your magnesia products go per ton? [921]

A. Around \$60.

Q. Around \$60?

A. Yes.

Q. Can't you give us here an approximation, or an approximate average of your various and sundry magnesia products per ton?

A. If you want an average, use the \$46 figure.

Q. In other words, let us take that then, an average of \$46: Now, the price you were asking to charge or to have Pacific pay at that time, June 30, 1945, was \$3.76 per ton for gypsum, wasn't it? In other words, the average price or value of your magnesia products, according to your estimate, would be approximately 14 times greater than that of gypsum per ton, isn't that correct?

A. Yes, that would be about right.

Q. Now, on the basis of allocating your miscellaneous or indirect shipping expense on the basis of value, the ratio of charge against the gypsum, at least the gypsum sold to Pacific, should be as 1 to 14, compared to the charge to be made against the magnesia products, isn't that correct?

(Testimony of David Watt.)

A. Yes, that is correct.

Mr. Rosenberg: Mr. Bennett, I think if you checked your arithmetic, you will find you have made a little error. I think 12 would be closer to it than 14.

Mr. Bennett: I am glad to have the correction. I didn't attempt to figure it here with arithmetical certainty.

Mr. Rosenberg: Multiply 3.76 by 12 and you get \$45.12.

Mr. Bennett: All right, we will accept the figure of 12 times greater value for the magnesia products than the gypsum that was sold to Pacific Portland Cement Company at that time.

Q. On that basis, and assuming that we only had down in that plant being shipped out the magnesia products and the gypsum, [922] on the basis of allocating overhead or indirect shipping expenses, gypsum would be charged with 8½ per cent of the total of that indirect expense; isn't that approximately right? A. Yes.

Mr. Rosenberg: What are you referring to now?

Mr. Bennett: I am cross-examining the witness to develop the effect of this change in methods of allocating the expense. We have agreed approximately on values. He says the average value of the magnesia products would be about \$46.

The Witness: I would like to say that this is very rough.

Q. (Mr. Bennett): Well, you said it runs from 30 up to, was it 60 or 80 dollars a ton for magnesia?

(Testimony of David Watt.)

A. To give you a correct average, we would have to go through all our sales prices and average them to give you a correct average.

The Court: There were four figures given and you agreed on an average of 45.

The Witness: 46, Your Honor.

The Court: 46, rather.

Q. (Mr. Bennett): And of course the value of the gypsum at that time I am taking as what they demanded that we pay them, that is, \$3.76. That is about on the basis of counsel for defendant's figures, one-twelfth of the value of the gypsum, or 8½ per cent. Now on the basis of allocating your indirect shipping costs on the dollar value as you did throughout [923] all the years of this contract until June 30, 1945, gypsum then should have borne only 8½ per cent of the total cost as compared to what magnesia would bear, isn't that correct?

A. That is correct.

Q. Now, if you had also the tonnages of the bromine and the lime and these other products you produced there, you would further depreciate and lessen the percentage of gypsum in relation to the total dollar values of goods shipped out through your shipping department, would you not?

A. You could add the lime but not the bromine. It is handled completely separate.

Q. The indirect shipping had nothing to do with bromine? A. It is completely separate.

Q. They had the matter of routing the cars, and so forth——

(Testimony of David Watt.)

A. That is all done in a separate portion of the plant, Mr. Bennett.

Q. You mean that the shipping department had nothing to do with bromine?

A. That is correct.

Q. But did have to do with the lime?

A. Hydrated lime, yes.

Q. And the values of the lime, or at least the manpower efforts in producing it, exceed that on gypsum?

A. No, That is not the lime here. This is quicklime and hydrated lime combined, and we shipped very little quicklime. [824] The quicklime went into this process here.

Q. Let us accept the 8½ per cent figure on the assumption that nothing was shipped but magnesia and gypsum. On the dollar value basis, the gypsum would be allocated 8½ per cent of the total overhead shipment?

A. That's right.

Q. When you changed it to a tonnage basis—and the tonnages run approximately equal, there is some difference; in the period July 1, '44, to June 30, '45, you shipped or you sold 39,305 tons of magnesia products and 32,582 gypsum. Now, assuming that all that gypsum that you have listed here as being sold was sold to Pacific—which of course is not the fact—the percentage, switching your system from a value basis to a tonnage basis, materially increases the charge that is made against gypsum, doesn't it?

A. It does. It does.

(Testimony of David Watt.)

Q. And raises the percentage about $8\frac{1}{2}$ per cent up to—well, I haven't figured the relation of 32 to 39, but approximately 40 per cent or more.

A. That is correct.

Q. Now, the effect of that change or refinement in your accounting methods, as I understood you to describe it, had the effect of loading onto gypsum a charge that formerly had been borne by your other products, isn't that correct?

A. That is correct. [925]

Q. And so far as the price that Pacific Portland Cement Company would have to pay for the gypsum, assuming that that was a proper charge of the cost of manufacture, that change in method would increase the price Pacific would have to pay for its gypsum during the next period, wouldn't it?

A. It would.

Q. So that change or refinement in your book-keeping process had the effect of substantially shifting the charge from your other products to gypsum, isn't that right?

A. That is correct.

Mr. Rosenberg: You mean as far as indirect shipping is concerned.

The Witness: Yes, indirect shipping only.

Mr. Bennett: Yes. There is no question about direct shipping expense. All the time we have been agreeable to paying that.

Q. You say that change, Mr. Watt, was made solely upon your own volition?

A. It was.

Q. You knew at that time that your company

(Testimony of David Watt.)

was trying to get a higher price for this gypsum?

A. I don't believe I even considered that.

Q. You gave that no consideration at all?

A. I don't believe so. It seemed to me that shipping expense on any other basis than the tonnage basis was absolutely and [926] basically wrong.

Q. Then your company had been wrong for ten long years.

A. I say they absolutely had been wrong for ten years.

Q. The only way in which that affected the company was that it didn't permit the company to get as high a price for the gypsum, assuming that any part of this cost could be allocated to gypsum, and it would under the method you devised in 1945.

A. That is correct.

Q. And isn't it a fact that the only reason you made that change at that time, Mr. Watt, was to add further to the price you thought you could charge Pacific Portland Cement?

A. That is not true, absolutely not. I don't believe I even considered gypsum when that charge was made. After all, gypsum is only one of 40 products that we make.

Q. But isn't it a fact, Mr. Watt, that the cost of handling the gypsum, and the amount, if any, of any supervision necessary to ship that gypsum out in bulk carloads to one customer, pumping it from the warehouse with a pump, and as soon as one car is filled, turning it into another car, that no greater burden was placed on that product in 1945 than before?

(Testimony of David Watt.)

A. I believe that is true. Nevertheless, the supervision charge in previous years had been wrong all the time as far as I was concerned.

Q. Now, as a matter of fact, then, Mr. Watt, the burden of supervising the shipping department, assuming that there is such a [927] burden, with the personnel involved in that, is far greater in the case of handling the magnesium products than the gypsum, the type of gypsum that you sell to other customers, than any amount of supervision that may be incidental to handling the gypsum sold to Portland Cement?

A. That I wouldn't know. That is a problem of our production department.

Q. You didn't investigate that at all when you made this change? A. No.

Q. Weren't you concerned with having a basis of allocation that reflected some truth in actual relationship between the amount of supervision to handle this gypsum you were loading with a new and greater charge—

A. No, the truth of shipping is the tonnage that is shipped. You can't get any closer to the truth.

Q. You knew this contract contained a provision that permitted your company to charge an increased price if during any twelve-month period there was an actual advance in the cost of manufacture of gypsum, didn't you? A. I did.

Q. And you knew for some period of time before there had been a dispute and controversy between your company on the one hand and Pacific

(Testimony of David Watt.)

Portland Cement Company on the other as to the costs of manufacture that should be considered in order to determine [928] whether any actual advance in the cost of manufacture occurred during any twelve-month period, didn't you?

A. I did.

Q. That question was very much in your mind at the time you on your own volition made this change?

A. It was not. I never even thought about it.

Mr. Bennett: Does Your Honor wish to take the usual recess at this time?

The Court: There are a couple of distinguished gentlemen that I anticipate are waiting for me, so we will take an adjournment at this time.

(Thereupon an adjournment was taken until 2:00 o'clock p.m. of the same day.) [929]

Friday, December 26, 1947, 2:00 o'clock p.m.

The Court: Proceed.

Mr. Bennett: So Your Honor will be better able to follow this document, I will hand you Plaintiff's Exhibit 18 which I am going to refer to in the further examination of this witness.

DAVID WATT

recalled as a witness in behalf of defendant, previously sworn.

Cross-Examination (resumed)

Q. (Mr. Bennett): Mr. Watt, have you treated in any different light so far as the allocation of expenses either direct or indirect, either those where you have actual cost records or those where you

(Testimony of David Watt.)

allocate by an arbitrary or related basis any difference between the gypsum that is manufactured and sold to Pacific and the other gypsum which is manufactured in some degree further by further processing and sold to other purchasers for chemical, pharmaceutical or scientific purposes?

A. No.

Q. You just treated all the gypsum alike?

A. Will you say that again?

Q. So far as allocating costs and making charges of costs, you treated all the gypsum you produced down there alike? A. That's true.

Q. And where you say you assign something to gypsum under [930] direct or undirect charge, it refers to total production of gypsum and not merely production of gypsum when the product is sold to Pacific Portland Cement Company?

A. No, in all these cases we were talking about gypsum sold to Pacific Portland Cement Company only.

Q. Do you treat the other gypsum you produce and sell on a different basis so far as assigning or allocating costs? A. No.

Q. You treat it the same?

A. Treat it the same.

Q. So in any of the statements that you have prepared included in the answer to the interrogatories and this form which is Plaintiff's Exhibit 18, where you speak of allocation to gypsum, you mean allocation to all the gypsum?

A. No, I mean allocation to PPC gypsum only.

(Testimony of David Watt.)

Q. How does your allocation to the other gypsum differ from the allocation that you have shown, say, in Plaintiff's Exhibit 18 to the gypsum sold to Pacific Portland Cement?

A. It doesn't differ at all, but this is only the allocation to PPC gypsum shown on this sheet. The other gypsum is not on these sheets at all.

Q. For instance, here under the last page of Plaintiff's Exhibit 18 at the top of the page bearing title "Westvaco Charges per books for cost of production to gypsum, shipping expense, tons produced," and you have given at the top the total tons [931] produced for the several years beginning with the calendar year 1937, and the year July 1, 1945, to June 30, 1946, is this tonnage reflected up there merely the gypsum that has been produced for and sold to Pacific Portland Cement Company?

A. No, that is all gypsum produced.

Q. Including the 4,000 tons or so that you sell to other customers? A. Yes.

Q. For scientific, pharmaceutical and chemical purposes.

A. I don't know what the purpose is, but the tonnage is there.

Q. So that the purpose of allocating cost, you treated that gypsum just the same as you have the gypsum that is manufactured and sold to Pacific Portland Cement Company?

A. In the production figure, yes.

Q. Coming down to the next title on this last page entitled "Shipping Expense," and title "Ship-

(Testimony of David Watt.)

ping Expense, Labor Loading, \$4994.42 for the period July 1, 1945, to June 30, 1946," is that charge, labor loading, only for the gypsum loaded and shipped to Pacific Portland Cement Company?

A. It is.

Q. That would be called by you a direct charge?

A. It would be, yes.

Q. There is no dispute about that, and never has been between your company and our company.

A. I understand that. [932]

Q. The next item is "Power—\$573.20." That is likewise called a direct cost of manufacture considered by you to be a direct cost of manufacture of the gypsum sold to Pacific Portland Cement Company?

A. Yes.

Q. It does not involve labor to produce or refine the other type of gypsum?

A. No.

Q. You say you have a separate account set up for that gypsum in your books?

A. We do.

Q. The cost for producing that gypsum is greater than the cost for producing the gypsum for the Pacific Portland Cement Company?

A. It is.

Q. What?

A. It is. I would like to add that after all this is bulk gypsum we are talking about, and the other gypsum is bags. Therefore, it is a higher cost in the bagging operation.

Q. It is further refined and processed in many instances, isn't it?

(Testimony of David Watt.)

A. No, I don't believe it is further refined and processed. The only process is putting it in the bags.

Q. But it is sold for various purposes, isn't it?

A. I don't know. [933]

Q. You don't know that?

A. I don't know.

Q. You have read the contract in this case?

A. Yes.

Q. Do you recall that refers to the reservation that Westvaco has in California and its successor has to sell 4,000 tons of gypsum for scientific, pharmaceutical or chemical purposes?

A. That is true, but I don't know that that is what it was sold for.

Q. Do you know who it was sold to?

A. I do.

Q. Who was it sold to?

Mr. Rosenberg: To which we object on the ground it is incompetent, irrelevant and immaterial. What difference does it make, Mr. Bennett?

Mr. Bennett: Well, I am not going to press the point although it does seem to me to have a bearing in connection with this matter of cost and charges.

Q. You say you don't know what it sold for before, Mr. Watt? A. No, I don't.

Q. Now, directing your attention again to this last page, "Westvaco charges per Books for Cost of Production to Gypsum, shipping expense"—again you have listed at the top the words "Gyp-

(Testimony of David Watt.)

sum Production," including gypsum you sent to others than Pacific Portland Cement. [934]

A. That's correct.

Q. In this column to the right, headed "T" and under which appears certain figures, for instance, opposite "Labor Loading" for this last period ending June 30, 1946, you have a figure "14." That means 14 cents per ton? A. That does.

Q. Was that figure of 14 cents per ton derived by dividing the total cost that you have noted for labor loading \$4994.42 by the figure 36658?

A. It was.

Q. You have charged, have you not, against the gypsum produced for Pacific Portland Cement Company, the cost of producing gypsum that you have sold to other people, haven't you?

A. No, we have not. This figure here——

Q. Just a minute. You are pointing to the figure \$4994.42 which is for labor loading.

A. Loading the gypsum sold to Pacific Portland.

Q. Yes, but as I understood it, you told me that this figure 14 cents was derived by dividing that total figure of \$4994.42 by the total——

A. By the total gypsum produced.

Q. (Continuing): ——by the total gypsum produced. A. That is correct.

Q. You have done the same thing on all of these items that also appear on that page where the cost per ton appears in this [935] column headed by "T." A. We have.

(Testimony of David Watt.)

Q. (The Court): Pardon me. What is the figure 36658T?

A. That is the tons of gypsum produced in that period.

Q. (The Court): In the bulk?

A. All gypsum.

Mr. Bennett: All gypsum.

The Witness: All gypsum.

The Court: All right.

Mr. Bennett: The bulk gypsum sold to Pacific Portland and other people produced for other purposes and sold to other customers.

The Court: I understand.

Q. (Mr. Bennett): In any event, the costs that you have itemized under the title "Amount" in each of these early periods is divided by the total tons of gypsum produced for all purposes including that sold to other customers.

A. That is correct.

Q. And the result of that division is the figure that you have listed in this third column under the title "T"? A. It is.

Q. Where you have attempted to estimate or set forth the cost per ton. A. That is correct.

Q. Is this figure \$4994.42 the labor that was involved in [936] loading all the other gypsum you produced and shipped to other customers.

A. No, it was not; it was the labor on that PPC gypsum only.

Q. Then, this figure of 14 cents per ton is not a true reflection of the total labor cost of all actual

(Testimony of David Watt.)

shipping on your gypsum, is it?

A. No, this is the PPC gypsum only we are talking about. Mr. Bennett, if we had used the actual gypsum shipped to PPC, then your unit cost would have been higher to PPC because we are giving PPC the benefit of using our total production.

Q. In other words, the cost of labor loading the other gypsum per ton is relatively higher than the cost of loading this? A. That is correct.

Q. Do you keep that is a separate account?

A. It is in a separate account.

Q. That account is available, is it, Mr. Watt?

A. It could be, yes.

Q. You could produce that without any particular difficulty?

A. For what periods?

Q. Say, this last period July 1, 1945, to June 30, 1946. A. It could be.

Q. And the preceding twelve months?

A. Yes, it could be.

Q. The "Power" item of \$573.20 that you have listed there, is that the power that is directly used in loading from the warehouse [937] into the cars the gypsum that is sold and delivered to the Portland Cement Company? A. It is.

Q. And it does not include anything for the loading or shipping of the other gypsum?

A. No, it does not.

Q. That again is considered by you and listed by you in your answer to the interrogatories as well

(Testimony of David Watt.)

as this document, Plaintiff's Exhibit 18 as a direct charge. A. It is.

Q. Now, we come down to the title in brackets "Allocated Expenses" in which you list on this particular sheet of Plaintiff's Exhibit 18, "Demurrage, Shipping Foreman, Shipping Foreman Assistants, Shipping Clerk, Warehouse Labor, Tractor Expense, Labor for Tractor," and you have a total there of \$4859.99. That is the total sum that you have sought to allocate against the shipping of the Pacific Portland Cement Company gypsum for these allocated items of expense, is that correct?

A. Yes.

Q. And each and all of those allocated expenses as they are set forth in this document, Plaintiff's Exhibit 18, are what you consider and have denominated in your answer to the interrogatories as indirect expenses? A. It is, yes. [938]

Q. Now, I notice at the bottom of this particular page the following notation:

"In preparing this schedule on shipping expense, actual labor and power have been shown for the years in question. However, costs of repairs and allocated expenses have been shown in total as it would be impossible at this date to go back to the earlier years and break down the individual items as many of the records are no longer extant."

What do you mean when you say that the allocated expenses have been shown in total in this notation?

A. Just what it says. It is in total, all of these expenses are combined and shown in total.

(Testimony of David Watt.)

Q. You are unable to show or establish from any available records or records that were available at the time that you prepared this document, Plaintiff's Exhibit 18, as to the particular amount of the charge or the basis for the charge of items such as "demurrage, shipping foreman, shipping foreman assistants, shipping clerk, warehouse labor, tractor expense, labor for tractors," is that correct?

A. That is correct.

Q. Let us confine ourselves to this last year of July 1, 1945, to June 30, 1946—what actual demurrage charge was made to you by any railway, railroad or other shipping concern for demurrage on any cars or vehicles for transportation involved in the shipping of any gypsum to or for Pacific Portland Cement [939] Company?

A. I don't know. I would have to go back and check every record we have, every demurrage bill to see if there was such a thing.

Q. Did you do that when you prepared this document?

A. I certainly did not. I didn't have the time or the staff to do that. After all, I understood that PPC was to send down a certified public accountant to do it, and the next thing I knew we were asked to do it, and in the limited time I could spare I got these figures for you.

Q. You didn't find any?

A. I don't know. I didn't check to find any.

Q. Just a moment. You don't know of your own knowledge now or from anything that you ascer-

(Testimony of David Watt.)

tained while you were preparing this document, Plaintiff's Exhibit 18, that there were actual demurrage charges for the period July 1, 1945, to June 30, 1946?

A. I couldn't say whether there were any or not.

Q. With that absence of information you simply arbitrarily assigned a certain percentage of cost for demurrage, was that so?

A. I didn't assign anything for demurrage charges.

Q. Why did you include it in the title, "Allocated Expense Total"?

A. If you look there, the figure is opposite all of them.

Q. This sum of \$4859.99 which you have charged against the [940] production only of the Pacific Portland Cement Company gypsum in that yearly period, July 1, 1945, to June 30, 1946, you can not say as to the amount if any were demurrage charges which the company had to pay or bear for any gypsum cost?

A. No, I can not.

Q. What about the next item, "Shipping Foreman"?

A. All of these items are bracketed together, which means that I cannot say the exact amount of any of these items. That is why they were grouped together and put in as a total amount.

Q. Well, the total amount of these allocated items are almost equal to the total amount of the direct and actual expenses, the labor and power involved in loading.

(Testimony of David Watt.)

A. Could I see one of these sheets, please?

Q. Yes, certainly.

A. In this case definitely it would be because of the allocation being split on a tonnage basis—it definitely would be about the same——

Q. And it makes a much larger figure and it makes a much larger cost than when you formerly allocated it on a value basis.

Mr. Rosenberg: What do you mean by “much”? The figures speak for themselves, don’t they, Mr. Bennett?

Mr. Bennett: I think so.

Mr. Rosenberg: Well,——?

Q. (Mr. Bennett): That is a fact, isn’t it?

A. Well, it is right there, Mr. Bennett.

Mr. Bennett: Yes. The witness, in fact, has said that in his previous answer.

Q. How much did you allocate of this total sum of “Allocated Expenses—Indirect Expenses” to the shipping foremen for the shipping of the gypsum delivered to Pacific Portland Cement Company?

A. How much of this figure is for shipping foremen?

Q. Yes. A. No, I have no idea.

Q. You have no idea at all?

A. No, I haven’t. I have said, Mr. Bennett, these were totaled together.

Q. I know you have said that.

Mr. Rosenberg: What is the use of questioning him then?

The Witness: What is the use of questioning me?

(Testimony of David Watt.)

Mr. Bennett: I think I am entitled to that.

Mr. Rosenberg: Just a moment. The witness said in order to get this material out for Pacific Portland Cement Company, because they did not want to spend the money to do it themselves that in the light of the limitations of time and personnel, he took the total figure which is a correct figure, but he did not have an opportunity to break it up into separate accounts.

The Court: I followed that testimony. [942]

Mr. Rosenberg: Then what is to be gained by taking each separate amount? I will stipulate that the witness will say in the light of the unavailability of the records to him that he could not work each separate item out, and he will say the same with regard to each item.

The Court: I suggest that will be sufficient for our purposes.

Mr. Bennett: Then I will ask him the question, if I may, Your Honor:

Q. The same answer you gave as to demurrage charges, shipping foremen, you would give to the other items, namely, shipping foreman assistants, shipping clerk, warehouse labor, tractor expense, labor for tractor, is that correct?

A. That is true.

Q. When did you first start preparing information for this document, Plaintiff's Exhibit 18, Mr. Watt?

A. I don't remember the exact date. I believe Mr. Rosenberg or Mr. Kaapcke could tell you the exact date.

(Testimony of David Watt.)

Q. It was several months since you started to do that?

A. It definitely was not several months ago. It was a more recent date than that.

Mr. Rosenberg: The record shows it was transmitted by me to your firm on November 24.

Mr. Bennett: I know that. I did not ask him when it was delivered. [943]

Mr. Rosenberg: That is when the work was done.

The Witness: That is when the work was done.

Mr. Rosenberg: When it was completed, I sent it to you.

Mr. Bennett: I will pass that point a minute and maybe we can be of some aid in refreshing the recollection of the witness in that particular.

Q. As I understand it, at this time, today, you are unable to say the percentage of this total sum of \$4859.99 that you allocated for indirect shipping expense for any of these items included under the title "Allocated Expenses," is that correct?

A. I am.

Q. Pardon me?

A. I am still unable to say.

Q. Then this figure just represents a total of what you allocated for these particular indirect items in connection with shipping? A. It does.

Q. And you are unable at this time to furnish any further detail concerning that allocation?

A. That's correct.

Q. (The Court): Why?

(Testimony of David Watt.)

A. It would take so long to work it out and go back to the old records and also some of the old records are no longer available for that. I could quote, for instance, time cards. The ordinary time card is not kept beyond the period of three [944] years by our company, and to take some of this, of what Mr. Bennett was asking for on the shipping clerk, or the shipping foremen, I believe he said, we just don't have the records behind that to get that any longer.

Q. (Mr. Bennett): Mr. Watt,——

(Addressing the Court): Am I interrupting, Your Honor?

The Court: No.

Q. (Mr. Bennett): Mr. Watt, all I am asking about at this particular juncture is the allocation you made for the period July 1, 1945, to June 30, 1946. A. Yes.

Q. You mean to say that you don't have records available to show the amounts and calculations and the basis for these allocations?

A. We have records that far back, yes, but it would take weeks to work it up in the way you people want it and we just have not the staff or the time to do it right now.

Q. It is a fact we sent this form to be filled out by you on October 21 of this year, isn't?

A. I don't know.

Mr. Bennett: Well, counsel, will you stipulate to that fact to save us time?

Mr. Rosenberg: Yes, and I will also stipulate

(Testimony of David Watt.)

from the time I received it, Mr. Kaapeke and I were discussing the matter for approximately two weeks because it was explained to [945] him that certain information he wanted could not be given in the form he wanted and we spent approximately two weeks, and in the meantime he told me he was in conference with Mr. Flick before these sheets could ever be turned over.

Mr. Bennett: You got the sheets on October 21, did you?

Mr. Rosenberg: Yes, but that is only half the story?

Mr. Bennett: There were no further changes made by either Mr. Kaapeke or Mr. Flick after that time, were there?

Mr. Rosenberg: Are you asking me?

Mr. Bennett: Yes.

Mr. Rosenberg: Obviously there were not. But the information was not furnished in the manner requested by you for the reason stated by the witness.

The Court: Let me ask a question in order to clear this up:

Q. You have an item here, "Warehouse Labor," in that bracket. A. Yes.

Q. Now, if you were to consult your books, in what manner would you check that item?

A. First of all, we would go to the distribution cards, each individual man's distribution card and run down every distribution card, maybe 10 or 15 on each individual card and pick out item by item, day by day charged to that account.

(Testimony of David Watt.)

Q. How would that be charged to that account, on an hourly basis or daily basis? [946]

A. On an hourly basis.

The Court: I don't know how they could do more. Maybe it is me.

Mr. Bennett: We are entitled to know what it is.

The Court: But you must keep in mind the conditions under which this sheet was made up, the time and personnel needed. All those things must be considered in determining this testimony.

Mr. Bennett: Your Honor, let me point out this, these are all allocated items.

The Court: I understand that. They did that hurriedly to satisfy you people, in furnishing to you information.

Mr. Bennett: That is the way they claimed the increase and——

The Court: Yes, they claimed that on cards. That is the reason I asked this question. They have cards on an hourly basis.

Mr. Bennett: Let me point this out, if I may, Your Honor, if you will just look up ahead on the shipping expense where the direct labor was involved. That was on the basis of accounting——

The Court: Here is where we get confused and I am not impressed by this—here is a sheet made up hurriedly without consulting the data on which it was based, and that is in the books. Is that correct or not? [947]

Mr. Bennett: That is one of the reasons I did not want to be bound by one of these figures. It now

(Testimony of David Watt.)

appears that even the witness can not determine or tell how much is allocated.

The Court: He does not make any pretense of doing that. [947-A]

Your Honor, let me also clear this point up. The witness has already testified that this particular item, Warehouse labor, that your Honor's attention was directed to, was not an item allocated on a time card basis, but was allocated on a tonnage basis. In other words, they took the tonnage——

The Witness: Mr. Bennett is wrong there. Originally it is allocated on a time basis.

The Court: And then a tonnage basis.

The Witness: And then allocated to gypsum on a tonnage basis.

Mr. Bennett: The point I want to make here, and apparently we are not thinking of the same thing, is that it was not figured as the direct items of labor were figured, and they had apparently to get these figures, the records of the actual amount of labor required in loading and handling gypsum for this period, and we are willing to accept their figures, but when we come down to these allocated items, your Honor, they are not items on which either this document or the witness' testimony—— your Honor said something about a certain sum that has been allocated for warehouse labor. That is what I am trying to find out, and he says he can't tell us.

The Court: I can understand why he can't. That is the point I am trying to develop, and if I am wrong I will stand corrected.

(Testimony of David Watt.)

Mr. Bennett: He said warehouse labor was kept on a [948] time card basis.

The Court: Yes, up to the period they went over to the tonnage basis. Am I correct?

The Witness: Yes, absolutely correct. To begin with, it is based on labor's hours, so much money, and then the money is allocated on a tonnage basis to the various products.

Mr. Bennett: I think your Honor has been confused by this answer of the witness, which is in contradiction to what he first said. Prior to June 30, 1945, he said, these indirect items in the shipping department, of which this warehouse labor was one, was allocated on a value basis. Your Honor remembers that, don't you?

The Court: Yes.

Mr. Bennett: In other words, they took the value of the products that were shipped out of the warehouse, and as the value of, say, the magnesium products bore to the gypsum products, they made this arbitrary allocation. It was not on a direct labor basis at all, even prior to 1945.

The Court: I followed the testimony. It changed from time to time.

Mr. Bennett: But I wanted to correct what appears to be your Honor's misapprehension of the fact that it previously had been allocated on a labor basis. None of your indirect shipments had been allocated.

The Court: I am not laying down any doctrine that it has [949] been constant in relation to this bookkeeping or whatever you wish to call it.

(Testimony of David Watt.)

The Witness: Might I ask Mr. Bennett one question, please?

The Court: Maybe the witness can straighten us out.

The Witness: I don't know what Mr. Bennett means, but you have down here "Warehouse labor," or at least that is one of the headings that your client put on here. Now, that warehouse labor is labor directly determined before it is allocated, so to find out what it is we would have to go over every individual time card of every man in the plant to find out how many dollars we start with before we even commence to allocate.

Q. (Mr. Bennett): Wasn't the warehouse labor in this item of allocated expense labor that had to do with all the warehouse activities, the shipping of magnesium and the other products?

A. Other than direct labor, yes; possibly the **janitor**, or some miscellaneous items.

Q. Yes, it may have been the janitor. Your time card didn't show what percentage of time he spent for gypsum? A. It certainly didn't.

Q. Or what percentage of time he spent for the other things that were shipped?

A. No, it didn't.

Q. In other words, when you got up this sheet, here, you had some figures somewhere in some manner showing that there was an item of warehouse labor that was not directly connected [950] with the manufacture of gypsum, is that correct?

A. Which figure are you talking about now?

(Testimony of David Watt.)

Q. The thing we have been talking about for ten minutes. A. This 4859.

Q. The item of warehouse labor, which is apparently part of that, which you said were allocated in total, as it would be impossible at this date to go back and break down the individual items. I am asking you now if that item of warehouse labor didn't involve some labor that had to do with the handling of your shipping department that was in no way broken down to percentages of of time spent for gypsum or time spent for the other products. A. That is correct.

Q. All right, now, you can't tell us, as I understand it, how much of this \$4859 you allocated to warehouse labor, can you? A. No, I can't.

Q. And the same answer would apply to each of these items on the sheet?

A. Each one of them.

Q. And in addition to that I understand that you don't know whether there were any demurrage charges for gypsum shipments?

A. I didn't say that. I said I wasn't sure. I said I would have to check back and find out.

Q. Do you have any recollection of seeing any demurrage charges for this period from July 1, 1945, up to June 30, 1946, that had [951] anything to do with gypsum?

A. I said I don't know. I don't handle that. That is one of the accountants in the accounting department.

Q. You are in charge?

(Testimony of David Watt.)

A. True, but I don't look at every bill that is paid. I doubt if Mr. Flick does, either. I doubt if we could do our jobs if we did that.

Q. We were furnished this form filled out by the defendant on November 24, 1947. Now, in the event that the plaintiff or some representative of the plaintiff went down to your plant to verify these so-called allocated expenses, would it be possible now to get all of the records and data which would show actually the existence of the basis for this allocation of each of these items?

A. It could be, yes.

Q. How long would that take? A. Weeks.

Q. It would take weeks?

A. Sure. This is done on a **month-by-month** basis, and when you start going over these time-cards, all of these books, every voucher we have got month by month to establish a monthly figure before you get the yearly figure, it would take weeks of work. That is why we haven't done it here.

Mr. Bennett: Your Honor, perhaps, realizes why in the short period we had to send a certified public accountant down [952] there we didn't do that, aside from the expense involved to us.

Q. This shipping foreman that you have in that department is the man that takes care—is the supervisor of the whole shipping department?

A. That is correct.

Q. What percentage of his salary did you allocate in that last period, July 1, 1945, to June 30, 1946, to the production or the cost of manufacture

(Testimony of David Watt.)

of the gypsum that was actually sold and shipped to or for Pacific Portland Cement Company?

A. Cost of production?

Q. Yes.

A. Nothing in the cost of production.

Q. In other words, you didn't consider that the shipping foreman's salary was an item involved in the cost of production of gypsum?

A. It is part of the allocated shipping expense.

Q. What did you mean when you said you didn't consider it cost of production?

A. I thought you meant this cost of production in the top part of the sheet, here.

Q. This direct cost?

A. This direct cost, yes.

Q. You don't consider that the shipping foreman is an actual part of the cost of production of gypsum?

A. I definitely do, an allocated portion. [953]

Q. All right, what portion of his salary was allocated for this year in question, July 1, 1945, to June 30, 1946?

A. It was allocated on a tonnage basis.

Q. Can you tell us what percentage of his salary——

A. Absolutely not. I don't go around carrying in my head the salaries of all of the persons that work down there.

Q. I am not asking you what his salary was. I asked what percentage of his salary——

A. I don't carry the percentages, either. The

(Testimony of David Watt.)

percentage of gypsum is 50 percent of the total tonnage; therefore, we can assume it is 50 percent of his salary.

Q. But you don't know actually whether that part of the allocation which totals \$4859.99 involved half of his salary, or some greater or lesser amount?

A. No, I don't.

Q. By the way, what figures did you use for these several items that you have under "allocated expense" to arrive at this total, this exact total that you have put down, \$4859.99?

A. It is very easy. It is the first two figures deducted from the final figure. It gives you the balance of the allocated.

Q. I don't know that I can follow you there.

The Court: Develop that further.

The Witness: It is the two direct figures, labor, loading and power, deducted from your total shipping expense, gives you your allocated figure. [954]

Q. (Mr. Bennett): You had a record showing the total shipping expense? A. We did.

Q. Did that record you had showing the total shipping expense from which you said you prepared this document, Plaintiff's Exhibit 18, show the amount of demurrage that had been charged?

A. No, it did not.

Q. Did it show the amount of shipping foreman? A. It did not.

Q. Or the other items that appear under "Allocation"? A. Not as such.

Q. How do you arrive at this 4859?

(Testimony of David Watt.)

A. I just told you, by difference.

The Court: On a tonnage basis.

The Witness: I just told you by difference. Here is your total charges to gypsum which, less your two direct charges, gives you that amount.

Q. (Mr. Bennett): Well, as I understand it—perhaps I am not sure I do yet—you had total shipping expense charged against gypsum of \$10,427.61; is that correct? A. That is correct.

Q. Now, you had some direct—you had definite records of the direct charges, the actual labor that was employed in loading the gypsum, and the actual power that was involved in loading the gypsum, and you subtracted simply that sum from [955] the total, and that give you the \$4859.99; is that correct? A. That is correct, yes.

Q. All right, but did your total charge of shipping that you had listed against gypsum, \$10,427.61, show the several amounts of the cost of shipping foreman and the shipping clerk and demurrage?

A. No, it definitely does not. Our books aren't kept like that.

Q. And I don't know how we could have gotten the figures.

A. Well, after all, we got them, and we keep our miscellaneous shipping expense in one account, irrespective of whether it is labor, supplies, or what-not, and the total each month is split over all the products on a tonnage basis, and to get these figures you are asking for we would have to go every month, every voucher, every time card, and identify every charge into that account.

(Testimony of David Watt.)

Q. You more or less have to do that if one is to arrive at any accurate or actual cost, don't you?

A. Why? This is the detail requested by you. We can reach an accurate cost without going into that detail.

Q. The details requested by us followed the details outlined in your answers to the interrogatories——

A. I don't know——

Mr. Rosenberg: They certainly don't, Mr. Bennett.

A. (Continuing): ——I have never seen these before.

Q. (Mr. Bennett): Let me cover it this way——

A. I would like to know where these come from, as a matter of fact.

Q. That has been shown by Mr. Flick's testimony, if you listened to it.

A. I wasn't here then.

Q. All the years you have been keeping your cost figures you have considered these items under "Allocated expense," "Demurrage," "Shipping foremen," "Shipping Foremen assistant," "Shipping clerk," "Warehouse labor," "Tractor expense," and "Labor for tractor," as indirect shipping expense?

A. I didn't list these. You listed these.

Mr. Bennett: Will you please read the question, Mr. Reporter?

(The reporter read the question.)

Q. (Mr. Bennett): As indirect shipping expenses, have you not?

A. Which items?

(Testimony of David Watt.)

Q. Well, I just read them, the items that are listed here as allocated expense, demurrage, shipping foremen, shipping foremen assistant, shipping clerk, warehouse labor, tractor expense, and labor for tractor.

A. For instance, I would like to know where this came from. I didn't say there was any demurrage in there.

The Court: Where did it come from, do you know?

Mr. Bennett: It came from the other side, the defendant. [957]

The Witness: Where?

Mr. Bennett: Well, we will show that in a minute. I am informed, if your Honor please, that when in January, 1944, Mr. Flick visited the plant of Westvaco, Mr. Cuneo, the predecessor to Mr. Watt, informed him that they classed and listed as allocated expense in the shipping department the items that appear on the form, Plaintiff's Exhibit 18. Now, if there is any question of that being the fact. I will withdraw this witness and ask Mr. Flick to go back on the stand, but I don't know that that is particularly necessary.

Q. Let me see if I can clear it in this way. Showing you again this last sheet of Plaintiff's Exhibit 18, entitled, "Westvaco charges per books to cost of production of gypsum shipping expense," all of the items appearing in there constitute all of the items that you had charged against shipping

(Testimony of David Watt.)

expense for this gypsum shipped or sold to or for Pacific Cement Company?

A. Yes, in this total amount, here.

Q. Right, but are there any other items——

The Court: Just a moment, "on this total amount here," for the purpose of the record what is that?

The Witness: This total, \$10,427.61.

The Court. All right.

Q. (Mr. Bennett): Are there any items that do not appear on this particular sheet of this Plaintiff's Exhibit 18 entitled [958] "Shipping expense" that you have ever considered under the title "Shipping expense" that you have ever considered under the title "Shipping expense" in the allocation of costs against gypsum sold to Pacific Portland Cement Company?

A. Could I have that question again, please?

Mr. Bennett: Read it to him, please.

Mr. Rosenberg: You mean any type of expense not shown on there? Is that what you mean?

Mr. Bennett: Any type of shipping expense charged or allocated to gypsum does not appear on that document. A. I would say no.

Q. In other words, the items that appear on this sheet entitled, "Shipping expense," in Plaintiff's Exhibit 18 are all of the items, both direct charges and indirect charges, that go to make up any shipping expense you have ever considered as a charge against gypsum sold to Pacific Portland Cement Company, is that correct?

(Testimony of David Watt.)

A. Well, the probable items.

The Court: Is this the total charge?

The Witness: No, your Honor. I understand he is asking me if these are all the items. I have already said that I do not know, because these have not been checked. There may not be any demurrage. There may be something else in there, so I say they are the probable items.

The Court: All right. [959]

Mr. Rosenberg: Is there any question about the total, Mr. Watt?

The Witness: None, whatever. The total we will stand on.

Mr. Bennett: I am entitled on cross-examination, I think, to ascertain how he gets that total, and that is what I am trying to do.

The Court: Let me call this to your attention: These various items that we are examining on now were hastily gotten together.

Mr. Bennett: Yes, your Honor.

The Court: He simply tells us he is unable to check those in the manner in which you wish him to check them, namely, back to the source in detail.

Mr. Bennett: Well, as long as it is definite—

The Court: Am I correct or mistaken about that?

Mr. Rosenberg: I think I could straighten Mr. Bennett out on that.

Mr. Bennett: Your Honor, I am afraid that the point has been entirely missed about this thing.

(Testimony of David Watt.)

A demand for a raise has been based on this thing——

The Court: I understand that.

Mr. Bennett: They must have gone through this——

The Court: He says he didn't.

Mr. Bennett: How then can they claim a right to a raise? [960]

The Court: I am not keeping the books for either side. That is not my purpose here.

Mr. Bennett: The burden in this case, if they demand a raise and purport to show it, is to prove it.

The Court: You both answered ready for trial, gentlemen, and that is what I am trying to do.

Mr. Bennett: That is what I am trying to do.

The Court: You are trying to do the impossible, you are trying to go back to the source of the information that isn't here, and he says it is not here and he can't do it.

Mr. Bennett: Your Honor, let me suggest this to you, and then I will stop. The reason I do this is because I fear through my own failure the court has not got the point I wish to make. We are confronted by a demand for a price increase. We are told there has been an actual advance in cost. They furnished us figures. Now, to furnish those figures, your Honor, they must have had to dig out the facts and base them on something.

The Court: Here is the parting of the ways.

(Testimony of David Watt.)

I follow that clearly. What was the first date these figures were—that is, what we have got here——

Mr. Bennett: This price raise was first presented to us on September 13, 1946.

The Court: That isn't what we are talking about now. We are talking about the subject under examination. [961]

Mr. Bennett: I know, but, your Honor, those figures are purported to be the same as the figures they calculated over *a ago*. Remember, this third price raise that was demanded of us was demanded on September 13, 1946. They said, "Gentlemen, our costs, there has been an actual advance in our cost of manufacture of this gypsum that we have contracted to sell you, and this amounts to a certain figure, 86 cents per ton." Now, we have shown here by our witnesses, and I think it will be—we have shown here by our own figures that this 86 cents—there was actually 25 cents, according to their own assertion, of actual direct charges, and there is a balance in dispute here of some 45 cents.

Now, at that time, in order to base that charge, the defendant had to, if it did honestly and properly, had to determine, and determine actually, what the facts and figures were, so I think this court must assume that at that time, over a year ago, they had the figures, and they had the breakdown and detail. They couldn't have just drawn them out of the air with some rough approximation, but would have had to go into this thing in detail,

(Testimony of David Watt.)

just as any business concern would in determining their costs, so the court must assume, I submit, that this work was done to the point of allowing them to figure down these costs to the fraction of a dollar, that they went over these records and were able to say, "This is the cost for this indirect item, and this is the cost for that indirect [962] item."

Now, they come into court, and counsel, as part of his case, attempted to show your Honor that actually in the last 12 months' period *from 30, 1945, to July 1, 1946*, there was an actual increase of 86 cents, of which 46 cents amounted to indirect properly allocated charges. Now, obviously, I am entitled on this cross-examination to determine what they are, and if the witness says, "Well, I can't tell, I don't know whether they are there"——

The Court: He not only says that, but he tells you why. How is this court going to change that situation?

Mr. Bennett: Upon that basis I submit this court can't allow a 46-cent price increase, and if the question of indirect charges be considered by this court proper to allocate——

The Court: We haven't met that phase of the case.

Mr. Bennett: I thought we were right in it. I thought your Honor stated that the whole case turned on this witness' testimony.

The Court: I said that it was an important point. This is the gentleman that was responsible

(Testimony of David Watt.)

for this charge. That was the only thing I had in mind on that, not taking that as any more important than any other witness.

Mr. Rosenberg: Your Honor, may I just comment on Mr. Bennett's statement, because the thing is being put in a completely false light. [963]

The Court: You may.

Mr. Rosenberg: In September, 1946, we sent them a letter and a notice that our costs had gone up. We had our records then. We have them now, and they are available to them any time they want to go over them and ferret out these things, but they are saying this, and Mr. Flick must be getting a kick out of this, because I am sure he knows the answer better than I do, or Mr. Bennett does. They say, "You carry an account on your books. Let us take, for example, Supplies, and in the regular course of a business concern you will end up at the end of the month with X dollars for supplies," but they say, "Now, we say when your price—we say your price didn't go up." And they file a suit for that purpose, and it is their burden to show it didn't, and our burden to show that it did.

They say, "You have an aggregate amount of supplies, but we want to know how much typewriter ribbon you bought, how much of this you bought, how much writing paper, how much of a hundred and one different items."

We say, "We don't keep our books that way, but the basic records are there. It could be devel-

(Testimony of David Watt.)

oped, but that is not the way a business concern keeps their books.”

Mr. Bennett would have that appear, that we are guessing at figures, but we aren't guessing at figures. Our books would reflect those figures. We haven't them in the convenient form he would like to have them, and he doesn't want [964] to go to the expense of getting them, and he argues to the court that we have the burden. We have no burden to keep our books as he would like to have them kept. I understand how those books are kept, and Mr. Watt has explained it, that as the charges come in they are taken and allocated and you end up at the end of the month with a total figure. If anybody wants to, the Internal Revenue Department, or anybody else, they can go back to the original records and see whether those total figures are correct, and Mr. Bennett has the same privilege, but it is a little too expensive for him, so he wants us to assume that responsibility, and I say we are not under that responsibility, but that does not mean that our books are not properly kept, and that does not mean that it was not supported by our books. It is, and if they want to ferret out the original records and the source from which we keep our books, in good and businesslike fashion, that is their burden, and I don't want it pictured to the court that because we can't come up with the precise figures that would suit Mr. Bennett there is anything wrong with our bookkeeping. I invited Mr. Flick one day in my office to go over our books,

(Testimony of David Watt.)

and he didn't do it, and they are criticizing us because we haven't done the work and incurred the expense that is their responsibility as plaintiff in this suit.

The Court: You may be sure I will not do it. Gentlemen, we will take a recess.

Mr. Rosenberg: And I am sure I won't.

(Recess.) [965]

Mr. Bennett: Without any purpose of prolonging the time of this trial, I feel, however, I should say something so that my silence is not taken as a confession of agreement with what counsel has just said. It is not our theory, and if the question need be argued now, I can furnish Your Honor with ample authorities that in cases of this kind with the issues such as are presented to Your Honor, that it is not our burden to disprove the claimed amount of increase. The affirmative of that feature is upon the defendant. I want to state that position. I thought I had stated it before and I don't want the Court to feel that we are laboring forward here on any theory that the burden is upon us to disprove the fact that an increase has not occurred or that it has in an amount beyond that which actually occurred. I feel I should make that statement so the Court at least is not laboring under any misapprehension of our position. It would indeed be anomalous in a situation of this kind if such a burden were cast on the plaintiff. It would mean in effect, and that is all I interpret counsel's statement to be, that they can come along

(Testimony of David Watt.)

and tell us, "You have an increase of 86 cents," and it is up to us to accept their figures for it. That would put plaintiff or any person in the contractual situation of the plaintiff here in a very untenable position. We would just have to accept their arbitrary allocation of costs and that would be beyond our power to do that.

Now, I am going to ask Mr. Watt this question:

Mr. Rosenberg: Mr. Bennett, I might suggest to you that is not true at all. All you have to do is not pay us. We would have to sue you and we would have the burden of proof, but here you have brought this declaratory suit, and we understand each other. So if we are going to argue, I would want to argue this very fully.

Mr. Bennett: I recognize very readily where you would like to take the position where you would immediately cancel the contract. We are concerned with the continuation of the contract and our performance under it and the reason we sought this declaratory relief is because that is the only way in which this difference could apparently be resolved.

But I don't want the Court to feel for a minute that it is our burden to disprove the increase or establish the exact amount of the increase. That is the burden of the party having the affirmative on that issue and that is the burden of the defendant.

Q. Mr. Watt, when Mr. Flick and Mr. Bannard visited your plant the last time and consulted with you and went over the details concerning the third or last increase of 86 cents per ton, you told both

(Testimony of David Watt.)

Mr. Flick and Mr. Bannard that you would not permit them to examine your books other than those that strictly pertained to gypsum production, at least, you told them that they could not examine the books showing the total tonnage or price or details of the sales of both quantity and amounts of products [967] other than gypsum, isn't that correct?

A. Mr. Flick was not there. Mr. Flick never visited the plant with Mr. Bannard that I recall. I did tell Mr. Bannard that, but I also told Mr. Bannard at the same time that we would be glad to give him a certified statement for any figures that he wanted.

Q. You would give him a certified statement for any figures he wanted?

A. A certified statement.

Q. And you were prepared at that time to give him a statement that would have both basis and details of allocation of all of these claimed indirect items of shipping expense, were you not?

A. That is correct.

Q. And that was over a year ago?

A. That's correct.

Q. Since that time records and books of the details you were then prepared to furnish Mr. Bannard have become unavailable?

A. Not at all. I didn't say we would give him this detail. I said we would give him the basis of allocation which was tonnage or dollars.

Q. But the figures on which those bases were computed such as the portion of the shipping fore-

(Testimony of David Watt.)

men and the shipping foreman's assistant and the shipping clerk and the warehouse labor and the tractor expense and labor for tractors, you were prepared at that time to give him the details. [968]

A. I was not—not in that form.

Q. Well, in the form that would actually reveal how and why you made those allocations totaling altogether \$4859.99.

A. No, I never thought of it in that way at all. The certified statement, when I made that offer,—to me a certified statement was a statement showing total miscellaneous shipping expense—total—and the basis on which it was allocated to the various parties.

Q. You mean the basis, the percentage—

A. The tonnage.

Q. Yes, and the percentages that were assigned to gypsum.

A. Right.

Q. But you did not agree to furnish and you were unwilling to furnish to him at the time the figures behind that basis, that is, showing the actual amount of production and sale of the other products?

A. That is correct.

Q. That furnished to you the basis for your allocation?

A. That's correct.

Q. How did you expect or anticipate Mr. Barnard to be able to determine the correctness or the propriety of the allocation if you were not willing to furnish him the figures on which he could make such a calculation?

Mr. Rosenberg: He just said he was willing to give him the basis. [969]

(Testimony of David Watt.)

The Witness: I told him I was willing to give him this certified statement.

Q. (By Mr. Bennett): I understood you to say you would not give him that.

A. I was willing to give him a certified statement.

Q. But you were unwilling to have him check your books?

A. I don't think he has a right to see anything about other products.

Q. But in order to determine the propriety of any allocation, if allocation at all is proper, one would have to know what the total amount of production of all of the items and the total amount of the sales or the data on which any allocation was based, would he not? A. He would.

Q. And those were details you were unwilling to furnish Mr. Bannard?

A. No, I said I would furnish him with a certified statement.

Q. You said you would furnish him with a certified statement showing total sales of other products? A. No, total only.

Q. You mean merely the total you had allocated as overhead?

A. We are talking about shipping expenses, aren't we?

Q. Yes.

A. That total of the miscellaneous shipping expense and the total of gypsum sold and the total of the other products sold. [970]

(Testimony of David Watt.)

Q. On value as well as——

A. On value or tonnage, whichever it was.

Q. Yes? A. Yes.

Q. But to verify that certified statement you were unwilling to have him go behind that certified statement.

A. After all, a certified statement from a certified public accountant does not need any verification.

Q. You were not a certified public accountant?

A. No.

Q. Did you offer to have a certified public accountant at your expense furnish such a statement?

A. That is what it would mean—a certified statement. I don't think a statement by me would have meant anything.

Q. I read from the statement that you appended to this item of shipping expense:

“It would be impossible at this date to go back to the earlier years and break down the individual items because many of the records are no longer extant.” How would a certified public accountant be able to verify the basis of your allocation?

A. Are you talking about these last two years or the periods in dispute?

Q. I am talking about the two periods in this case, the period of the second claimed raise, the calendar year 1943 over the calendar year 1942, and the calendar year of July 1, 1945, to June 30,

(Testimony of David Watt.)

1946, over the similar period immediately [971] preceding.

A. The records are still available for July, 1944, to June, 1945, and July, 1945, to June, 1946.

Q. Are they available for 1943 and 1942?

A. No, some of the time cards are not there. We only keep time cards three or four years.

Q. So it would be impossible for an accountant, even if he were an outside certified public accountant, to verify the allocations that were involved in the second price increase period.

Mr. Rosenberg: Are we talking about shipping expense?

Q. (By Mr. Bennett): I am talking about all allocated expense as far as records are concerned.

A. As far as time cards are concerned, it would be impossible.

Q. It would be impossible?

A. It would be impossible for time cards.

Q. You knew ever since 1943 when you sent that notice of second price increase of 76 cents, that that matter was questioned and was a matter of dispute continuing down to the present time, did you not? A. I knew, yes.

Q. Were those records destroyed properly or through inadvertence?

A. Definitely not. The regular procedure is we keep them for a certain length of time.

Q. And then they are destroyed? [972]

A. And then they are destroyed. If you kept

(Testimony of David Watt.)

your records all the time you would need a huge warehouse to keep them all in.

Mr. Bennett: I refer, Your Honor, to this shipping expense page of this Exhibit 18 that you have before you.

Q. Were these items entitled "Allocated Expense" totaling \$4859.99 allocated only on the basis that the gypsum sold and delivered for Pacific Portland Cement Company, was that figure determined on the total basis of all of the gypsum produced?

A. No, only on the gypsum shipped to PPC.

Q. However, the arithmetic that appears on the column under the word or letter "T" amounting to 13 cents per ton, for that item, is arrived at by dividing that total into the total tons of gypsum produced, is it not?

A. That is correct. I already pointed out if we used only the gypsum shipped PPC you would get a higher cost per ton.

Q. Do you know what portion of time, for example, of the shipping foreman that he devoted to handling the shipment of all of this other gypsum that you sold to other customers and sold not in bulk, but in bags and other packages?

A. I do not.

Q. This allocation of the shipping foreman's time or expense that you allocated to the Pacific Portland Cement Company gypsum is just an arbitrary allocation, is it?

(Testimony of David Watt.)

A. No, it was allocated on a tonnage or a sales basis.

Q. Yes, but it was not allocated on any basis that you had [973] from records or otherwise of the actual amount of time that he spent, or the relative time he spent in handling Pacific Portland Cement Company gypsum and what he spent in supervising the other shipping operations of the company.

A. It would be impossible for a shipping foreman to keep his time on that basis.

Q. And for that reason of impossibility you simply made this allocation on the tonnage basis, is that correct? A. Yes, that's correct.

Q. And that tonnage basis of allocation was first put into effect June 30, 1946? A. 1945.

Q. 1945, yes—is that correct? A. Yes.

Q. Now, would you say the same thing as to the shipping foreman's assistant and the shipping clerk and the warehouse labor that is under this title "Allocated Expense," that you thought might be a janitor? A. Yes, it is on the same page.

Q. And the same thing with regard to tractor expense and labor for tractor?

A. That's correct.

Q. I note from the figures furnished on Plaintiff's Exhibit 18 that in the period July 1, 1940, to June 30, 1941, when 32,000 tons of gypsum were furnished, the direct charges for labor [974] loading, power, actually and directly put into the gypsum operation, as you say, affecting only the Pa-

(Testimony of David Watt.)

cific Portland Cement Company gypsum, amounted to \$1488.19, whereas such total charges for the period of July 1, 1945, to June 30, 1946, amounted to approximately \$5400. I note as to these so-called allocated or indirect items the first period, namely, July 1, 1940, to June 30, 1941, amounted to only \$1232.13, whereas you have allocated in the last period, namely, July 1, 1945, to June 30, 1946, a total of \$4859.99, or over three times more for these indirect items than you had for the period 1940 to 1941. Can you tell us, Mr. Watt, why your allocated expenses merely in the shipping department increased over three times in those two periods?

A. I would say the cost of labor and materials have gone up so much that they would have to increase that much.

Q. Well, the cost of labor and materials actually employed in the loading of direct labor charge in the loading of gypsum only went up approximately \$1,000, or less than one-third or less than one-fourth, whereas your overhead charges have gone over three times.

A. I wish you would give me the sheet so that I can follow you.

Q. Yes, certainly.

A. Point out the figures in this?

Q. This figure here for the first period for July 1, 1940, to June 30, 1941. [975]

A. This figure here compared with this figure here?

(Testimony of David Watt.)

Q. Yes.

A. As I have already said, the last figure of \$4859.99 is based on tonnage while this one here is based on dollar basis.

Q. And that reflects a many-fold increase in the so-called allocated indirect items.

A. It does. [975A]

Q. In any of the other products that you produced at Newark was there involved as there is in this case a contract or an agreement or any basis whereby the price to the purchaser of those products is determined upon an increase in your actual cost of production?

A. No, I can't think of any.

Q. In other words, this particular sale of gypsum to Pacific Portland Cement Company is the only situation of any customer of your Newark plant where a price to be paid by the purchaser is affected by an increase or a decrease in the cost of production? A. It is.

Q. You understand that in this case there is no decrease or lowering of the price, but if changes occur there is an increase? A. I do.

Q. And you also understand, do you not, that in this case if prices go down one year and then the next year they go up, that your company claims an increase in price for that increase that occurs in the second comparative period?

A. I understand that, yes.

Q. But where the prices go down during that

(Testimony of David Watt.)

12-months period, Pacific Portland is not entitled to any decrease in its prices? A. That is so.

Q. As a matter of fact, the direct cost of producing the gypsum [976] has not materially increased per ton over the base period of the original year when this gypsum was produced and the last period that we are talking about, the 1945-6 period, isn't that so?

A. Well, I wouldn't know. You can see from these sheets, I can't recall these figures.

Mr. Rosenberg: This is strictly argumentative, if the Court please. I suppose Mr. Bennett is now going to ask what the exhibit contains, and the exhibit is the best evidence.

The Witness: It is all stated there.

The Court: All we are concerned with here is the ultimate facts, gentlemen. The documents speak for themselves.

Mr. Bennett: That is true, your Honor.

Q. All these figures that appear in the summary to Plaintiff's Exhibit 18 were inserted by you or under your direction? A. They were.

Q. Showing the direct costs as well as the claimed so-called indirect costs for each year, beginning with 1937 and ending with the period July 1, '45, to June 30, '46? A. They were.

Q. Now, I direct your attention to the page of Plaintiff's Exhibit 18 having to do with "Direct charges," and you will notice under the title, "Materials and Supplies Operations," which is listed under "Direct charges,"—

(Testimony of David Watt.)

Does your Honor have that sheet? [977]

The Court: 18?

Mr. Bennett: It is on this page, sir. This is the new one, the direct charge.

The Court: Direct charges?

Mr. Bennett: Yes, directing his attention to the item "Materials and Supplies Operations."

The Court: Yes.

Q. (By Mr. Bennett): There appears here from your figures an increase in the last two comparative periods of 3 cents per ton in the items, "Materials and Supplies Operations."

A. That is correct.

Q. You notice that? A. Yes, uh-huh.

Q. Included in that 3 cents, 2 cents of which the plaintiff is not disputing, is 1 cent for the use of a low-pressure air compressor, is that not a fact?

A. That is correct.

Mr. Bennett: That does not appear on the document, itself, your Honor.

The Court: I understand.

Mr. Bennett: I will have to go briefly into the facts of that so that your Honor will have them.

Q. Up to March, 1945, this charge for the low-pressure compressor was always included in the general plant overhead expense, wasn't it? [978]

A. It was.

Q. And commencing in March of 1945 you changed your accounting system so as to assign that item of direct charge of expense, is that correct? A. That is correct.

(Testimony of David Watt.)

Q. Now, why was that done?

A. Well, we found that part of the cost of this low-pressure air compressor was being applied as overhead to products and accounts that had no benefit at all from the air compressor, so at that time we had the maintenance department give us an allocation to the correct accounts where this air compressor should be charged, and when we got that we changed it from overhead charge to direct charge.

Q. In other words, prior to '45 you had always charged this low-pressure air compressor to other items of production?

A. All over the plant as an overhead charge.

Q. And then in '45 you changed it so as to eliminate that charge as to certain other items?

A. That is correct.

Q. And made it as a direct charge against gypsum?

A. Well, more than gypsum, many other accounts, but gypsum was one of them.

Q. What percentage of the total cost of operating that low-pressure air compressor was charged to gypsum?

A. Off-hand, I don't know right now. I could find out, but it [979] was very, very small. Off-hand I don't know.

Q. This question was presented when Mr. Bannard's deposition was taken?

A. I don't know.

(Testimony of David Watt.)

Q. You were interrogated when Mr. Bannard's deposition was taken as to this charge?

A. I was not.

Q. Don't you remember the conversation between you and Mr. Kaapeke when your own counsel turned and asked why it was that this change was made in the air compressor charge?

A. I told you that there was change, but that is all.

Q. So that we are not arguing about unnecessary things, you know there was this question about this assignment or allocation of this air compressor sometime previous to this trial,—didn't you?

A. Oh, yes.

Q. But you haven't ascertained since that question was first raised the basis for allocating that expense as a direct charge against gypsum?

A. I had no reason to. I still think it is a correct charge against gypsum.

Q. But the percentage of the total cost you don't know?

A. Off-hand I don't know. I don't carry these figures in my head.

Q. Could that figure be ascertained? [980]

A. It could be, yes.

Q. To what other products do you assign it as a direct charge?

A. I believe if you look on that summary sheet of Mr. Bannard's you will find it right there. Mr. Bannard developed that in his column of differences.

(Testimony of David Watt.)

Q. Now, let me ask you this: Isn't it a fact that before you made this change in 1945 you assigned only 5 to 6 per cent of the cost of this air compressor in General plant expense to be charged to gypsum?

A. That I don't know. I haven't worked the figures out.

Q. I am trying to refresh your memory by the only knowledge that we have about it.

Mr. Rosenberg: Isn't that the percentage of general overhead that was charged to gypsum there? If that was in General overhead that would be the percentage charged.

Mr. Bennett: Yes, I assume that is approximately right.

Q. Now, since you made this change, the percentage of this so-called air compressor that you have charged against this gypsum as a direct charge is from 18 to 20 per cent of its total cost, is that not a fact?

A. Again I don't know if these figures are correct, but it definitely would increase.

Q. Well, there has been about a four times increase as a result of that change?

A. That is quite possible. If gypsum actually uses that they [981] should be charged for it.

Q. Why did you allocate 18 to 20 per cent of the cost of that low-pressure air compressor as a direct charge against the production of gypsum you sold Pacific Portland Cement Company?

(Testimony of David Watt.)

A. I didn't hear all that question. Would you repeat it, please?

(The reporter read the last question.)

A. Because that is the amount that should be charged.

Q. Upon what basis do you make that statement?

A. The basis that we got from the Maintenance Department for the use of the low-pressure air compressor.

Q. In other words, you got some estimate from them that they considered that would be approximately the charge they thought ought to be assigned to gypsum?

A. That is correct. I don't know any other way you could do it.

Q. For a great many years you included it in General plant expense and assigned five or six per cent to the gypsum cost?

A. True, but you can do something wrong, and there comes a time when the wrong should be corrected.

Q. And that correction had the effect in your accounting of increasing the cost of production or manufacture of gypsum?

A. That is correct, one cent per ton.

Q. For that comparative period?

A. One cent per ton.

Q. But you don't know of your own knowledge why or how this 18 or 20 per cent figure was arrived at?

(Testimony of David Watt.)

A. I would say through a time study by the Maintenance Department. [982]

Q. You didn't make any such time study?

A. I did not.

Q. When you made that change as to the second comparison period did you note back for comparative purposes the same charge in the earlier comparative period? A. I did not.

Q. Well, that has the effect, then, of an arbitrary or bookkeeping increase of so much per ton, in this case 1 cent per ton, in the cost of manufacture of gypsum, doesn't it?

A. No, I don't think that is the case.

Q. Well, so far as the comparative period is concerned, and in considering your two methods of keeping your books——

A. No, not at all. If you change your accounting then there is definitely changes in the cost of production of all products.

Q. Yes, so the comparison by which you figured or calculated there would be a 1-cent increase was based upon this change from allocating five or six per cent of the cost of its operation, the operation of this air compressor, to 18 or 20 per cent, is that correct?

A. I wouldn't say it was a change. I would say it was a correction, a correction of a bad allocation.

Q. What is that?

A. A correction of an allocation that was previously wrong.

(Testimony of David Watt.)

Q. In any event, there was such a change made?

A. There was, yes. [983]

Q. Now, was that change made pursuant to any instructions you had from your New York office?

A. No, it was not.

Q. It was made on your own—— A. Yes.

Q. ——volition? A. It was.

Q. And you realized when you were making that change that would, at least so far as your accounting system was concerned, add to the price of gypsum that Pacific would have to pay?

A. I did not.

Q. Then why did you go to the bother of making the change?

A. Mr. Bennett, gypsum is only one of many products.

Q. In the case of gypsum, there is a third person interested, and in the case of other products there is only your own company interested.

A. That is true. On the other hand, I was not thinking of Pacific or Portland, when I was making the change. As a matter of fact, how could I tell what it would do to the cost of production when I made the change? You can tell when you make an accounting change what the difference will be in the cost of production. It is only when you work it month by month that you can tell what the change is.

Q. When you multiply four times an item by a change in the method of accounting, it usually results in reflecting an increase, [984] doesn't it?

(Testimony of David Watt.)

A. It does, but I didn't know when I made that change that that would be the result.

Q. Now, that change, by the way, was not disclosed in your answer to our interrogatory that requested you to state the basis of all changes that were made in your accounting methods?

A. No, it must have been overlooked. It was so relatively small it must have been overlooked.

Mr. Bennett: I think counsel will concede that the answer to Interrogatory No. 10 did not state that particular change that was made.

Mr. Rosenberg: I don't believe it does.

Q. (By Mr. Bennett): Do you know what that air compressor is used for in your plant?

A. No, I don't. I know it has something to do with the loader and something to do with the vacuum pumps, but——

Q. The major portion of its use in any way is directly involved in the production or manufacture of other products, isn't it?

A. That I don't know. According to the allocation it would be.

Q. Yes, as far as you know, this increased percentage assigned to the air compressor was because of some estimate that had been given to you by someone else in the company, is that correct?

A. Yes, that is correct.

Q. At that time you were actually striving, though, weren't [985] you, Mr. Watt, to see how many items of cost you could add to the gypsum produced for Pacific Portland Cement Company in order to increase the price?

(Testimony of David Watt.)

A. I definitely was not. As I pointed out to you before, you can't tell what products are going to increase when you make a change like that. I was trying to get a better allocation for something I knew was wrong.

Q. So far as you know there wasn't an actual increase in the percentage of use of that air compressor in the second period where you increased the charge for it over the preceding period where the charge was approximately one-quarter?

A. There definitely was to the gypsum department, because the gypsum hadn't had their correct amount previously to that. [986]

Q. Well, no. You misunderstood my question, I think. As far as you know, there wasn't any greater use made of that air compressor in the second comparative period, beginning in '4—I mean in the last comparative period, beginning in 1945 over the preceding period, was there?

A. I still don't understand your question, Mr. Bennett.

Q. Well, as far as you know, the air compressor was used in the same way and to the same degree, its actual use, in 1945-'6, as it was used during the preceding period, isn't that a fact?

A. Yes, I would believe so.

Q. And as it had been used during all the previous years of this contract, isn't that a fact?

A. I would believe so, yes.

Q. And no one told you in the plant—well, withdraw that question.

(Testimony of David Watt.)

Now, you made a reference to sulphuric acid and you stated that up until the last period beginning in June, 1945, you had always charged sulphuric acid to another product. Now, the manufacture of the gypsum, if it was affected at all by the addition of sulphuric acid, had been so affected through all the previous years of its manufacture at this plant, had it not? A. I would believe so.

Q. And the only reason that you made this change—Withdraw that question.

And prior to 1945 you had never assigned this charge against [987] gypsum, either a direct or an indirect charge, of any cost whatsoever for sulphuric acid? A. That is correct.

Q. And you say the only reason you assigned for the first time in 1945 and 1946 that period, the last comparative period, the total cost of the sulphuric acid used in the plant against gypsum was because you had discontinued for the time being the manufacture of the bromine, to which product previously the total charge of sulphuric acid had been made, is that correct?

A. That is correct.

Q. Now, that change in the assignment of the charge had the effect, according to your theory and your basis of accounting, of raising the price of gypsum to Pacific 35 cents a ton, and later, as you reduced that figure, to 22 cents a ton.

A. 23.

Q. It would raise the price of gypsum to Pacific Portland Cement Company 22 cents a ton?

(Testimony of David Watt.)

A. 23 cents a ton.

Q. 23 cents a ton, thank you. I am corrected. Now, you resumed production of bromine again in 1946, didn't you?

A. Some time, yes, uh-huh.

Q. And during—and how long was that bromine produced in 1946?

A. I believe three or four months. I am not quite sure of that.

Q. During that three or four months, during that period of [988] time, you were not charging against bromine any part of the sulphuric acid that always previously you had charged against it?

A. That is true.

Q. And it was only after this suit was filed that you went back and made some charge against bromine produced in 1946 which had been previously assigned by you or charged by you against gypsum, is that correct?

A. That is correct. I found an accounting error and so adjusted it.

Q. And during that period of time you were producing bromine, did you charge against it all of the sulphuric acid used in the plant or merely allocate a certain portion of it?

A. Charged all of the sulphuric acid.

Q. You did? A. Yes.

Q. Are you producing bromine at the plant now?

A. We are not.

Q. When is the last time you produced any bromine there?

A. Back in '46, I believe.

(Testimony of David Watt.)

Q. Well, the best of your recollection is some time in 1946?

A. Some time in 1946, yes, sure.

Q. Now, according to the figures furnished in this document, which is Plaintiff's Exhibit 18, the photostat document, you have an item of engineering expense that is considered as an [989] indirect charge, is it not? A. It is.

Q. What page does that appear on here?

A. Sheet 3.

Mr. Bennett: That is sheet 3, Your Honor, entitled "Overhead and General Plant Expense." I guess we didn't mark those pages, Your Honor. This is the one I am referring to.

The Court: All right.

Q. (By Mr. Bennett): Now, please note the charge that you have for engineering as an indirect charge in 1941. I believe the figures are stated there by you to be \$367.10, which engineering charge was in 1941, and according to my reading of the chart, you show that for the last comparative period, June 30, 1945, to July 1, 1946, a charge allocated to gypsum of \$2,508, or approximately eight times the amount that you charged for engineering under general overhead to gypsum in the last period as compared to the period 1941. Will you explain why that eightfold increase occurred, Mr. Watt?

A. Well, in—our engineering department is much larger now than it was in the early days.

(Testimony of David Watt.)

Q. That was not necessitated at all by the gypsum operation in so far as the production of gypsum for the account of Pacific Portland Cement Company was concerned, was it?

A. I would say it was, a great deal of it.

Q. Well, upon what basis do you make that statement? [990]

A. Because——

Mr. Rosenberg: Just a moment now.

Mr. Bennett: Let the witness answer, please.

The Witness: Is there a question?

Mr. Bennett: Yes.

The Witness: What was the question, please?

(The Reporter read the last question by Mr. Bennett.)

A. The engineering department has as much work to do with the gypsum as any other product or any other department.

Q. What percentage of the engineering department, the total cost of the engineering department, do you assign or seek to assign or charge to the whole of your operation?

A. I don't quite get that.

Q. What is the total engineering department of your plant?

A. You mean in dollars?

Q. Yes.

A. I don't know. I wouldn't know offhand.

Q. Do you know what percentage of that total you charge to gypsum?

A. I do not.

The Court: It is charged on a tonnage basis.

The Witness: Not in this case, Your Honor.

(Testimony of David Watt.)

Mr. Bennett: Your Honor, there are all kinds of basis here.

The Court: Just a minute. Up at the top of the sheet it says "Amount Per Ton," on this sheet that I have got here. [991]

The Witness: That is the unit cost per ton, Your Honor.

Mr. Bennett: But it is not allocated on that basis, though, Judge.

The Witness: It is allocated on a labor basis, Your Honor.

The Court: On what?

The Witness: On a labor basis, Your Honor.

The Court: What do you mean by a labor basis?

The Witness: A direct labor basis.

The Court: Well, that answers it.

Q. (By Mr. Bennett): What I am trying to get out is what the total cost of his engineering department down there at the plant was.

A. I don't carry these figures around in my head, Mr. Bennett.

Q. Do you know the relation of the labor basis on which the charge is shown in Plaintiff's Exhibit 18?

A. I definitely don't know from this sheet here.

Q. Do you know whether it is on a 5 per cent or 10 per cent or 15 per cent basis?

A. I definitely couldn't say on that until I checked the figures.

Mr. Bennett: You know, counsel, don't you?

(Testimony of David Watt.)

Mr. Rosenberg: No, I don't, but I can get that for you.

The Witness: I haven't got these figures in my head.

Q. (By Mr. Bennett): Your own exhibit, Mr. Watt, Exhibit F to your answer to plaintiff's interrogatories, would indicate [992] under item 2 that the amount of overhead allocation was 7.8 per cent to gypsum.

A. That is the answer then, Mr. Bennett.

Q. All right, in other words, all these overhead items appearing on this particular sheet entitled "Overhead and General Plant Expense," were just assigned to gypsum and the figures on that page relate to the basis of assignment of 7.8 per cent of the total cost or charge for those overhead items for the whole plant, is that correct?

A. That is correct.

Q. Now, in determining the allocation of engineering, rather than determining the relative increase or decrease or actual increase or decrease in the amount of engineering services if any applied to gypsum, you simply applied this arbitrary figure of 7.8 per cent which represented the relation of direct labor employed in the drying, grinding and loading of gypsum to your whole Newark plant operation, isn't that correct?

A. You will have to read the question again.

(The Reporter read the last question.)

A. To the whole of the Newark? That was the gypsum portion of it only, yes.

(Testimony of David Watt.)

Q. But you simply applied to gypsum or allocated to gypsum 7.8 per cent of the total cost of your engineering department for this last period; wasn't that the way you did it?

A. That is correct, but it is done on a labor basis. [993]

Q. Yes, and the labor basis you refer to is the total cost of direct labor employed in the gypsum operation, the drying, and grinding and loading of gypsum, as applied to the total labor cost of your operation in the Newark plant.

A. As compared to the total labor cost, that is correct.

Q. And it was on that basis that you signed this charge of \$2,508.03 for engineering for the last period in suit, the last twelve months' period involved in this suit, June 30, 1945, to July 1, 1946, rather than upon any basis of an increase in actual engineering service in the manufacture of gypsum, isn't that so?

A. That I couldn't say. I do not control the engineering services or know anything about them.

Q. As a matter of fact, so far as you know, there hasn't been any more engineering service rendered in the last period than there was rendered in 1941 as far as the gypsum operation is concerned?

A. I definitely cannot say that or even agree to it, Mr. Bennett.

Q. Because you do not know, is that it?

A. I do not know.

Q. You do not know? A. I do not know.

(Testimony of David Watt.)

Mr. Bennett: All right. [994]

Mr. Bennett: Shall I go on, Your Honor?

The Court: Yes.

Q. (By Mr. Bennett): Since you started your operation in production of gypsum in 1937, you have greatly expanded your plant in other particulars, have you not, Mr. Watt?

A. In what particulars? I am not quite sure what you mean by that question, Mr. Bennett.

Q. You have gone into the production of new items and products; you have erected additional plant facilities and in general expanded the scope and extent of your operations, have you not?

A. I would say so, yes.

Q. In the engineering field during the war, you built here, or someone built them for you at the plant, a catalyst plant, is that correct?

A. That was not for Westvaco.

Q. What?

A. That was not for Westvaco.

Q. Wasn't that operated by Westvaco during the war period?

A. No, that was operated by Westvaco as agents for rubber reserve.

Q. In the operation of that plant you had certain new and additional overhead items that had not previously been involved, did you not?

A. No, in the newer plant that was a complete and separate unit on its own. [995]

Q. Isn't it a fact that the plant guards you had

(Testimony of David Watt.)

during the wartime were primarily required for the protection of this particular catalyst plant?

A. No, they were not for that purpose. The guards were on that plant payroll.

Q. Why was it that during the war period you had guards that you did not have at other times?

A. I don't know. You would have to ask the production department.

Q. That was not in any way necessitated by this catalyst plant.

A. No, it was not in any way necessitated by that.

Q. And it was not necessitated in any way by the selling of gypsum to Pacific Portland Cement.

A. I would say certainly it was. Pacific Portland Cement should take a part of it just as anyone else.

Q. Outside of the manufacture for sale to Pacific Portland Cement Company, you were manufacturing products for sale to the federal government or some of its agencies. A. We were.

Q. And as a part of those contracts you were required to furnish plant guards.

A. That I cannot say; that I don't know.

Q. Wasn't that really the reason you put on the plant guards during the wartime to comply with requirements you had in [996] contracts with the federal government to protect your operations in so far as the federal government was concerned, a protection entirely apart from the gypsum that you were selling Pacific Portland Cement Company.

(Testimony of David Watt.)

A. I cannot answer that because I don't know.

Q. You don't know? A. I don't know.

Mr. Bennett: Does Your Honor wish to go on at this time?

The Court: I am trying to get through with this case. That is the reason I am running later than usual tonight. I would not want the record to show I am being imposed on in this case. But it is bordering on that, gentlemen, if I have any conception of my duty. I say that without reservation.

Let us proceed. I am going to get through with this case. There is no reason why this Court should be turned over to a bookkeeping process, and after experts, able to represent both sides, testify, and to have me determine and sit in judgment on them with the presentation of this case in the fashion it has been presented, I am free to say that there is a situation engaged in here that does not belong here.

Mr. Bennett: I don't know but I am going to agree with Your Honor perhaps to this extent, that in view of the period of time, and I am conscious of that, that this case has taken, and knowing Your Honor's attempting, as presiding judge, to expeditiously handle a tremendous load of litigation, that at least, [997] comparatively, a long period of time has already been spent in this case. It might have been better, if Your Honor please, in the light of those considerations to have had what Your Honor has perhaps done before, a reference to a master. As Your Honor recalled, we

(Testimony of David Watt.)

tried to arbitrate this matter from the beginning and the other side would not agree.

It is true that this case involves a great deal of detail and accounting, but, however, as Your Honor told us Wednesday noon, this goes somewhat to the essence of this case. This is an unusual case. It is not the type of case that ordinarily comes before the Court, but it is one of those matters that has arisen in our life and the lives of these two business concerns involving an important contract. I cannot claim that merely because it is important that it requires any undue allocation of time by the Court, but I don't know how in view of the issues involved and the necessary facts upon which the Court may base an advised opinion when the case is through, it would have been possible for us to proceed other than we have attempted to do.

The Court: I fully appreciate your difficulties, but I did not bring your difficulties in here. I can understand those things. I have seen so much of this that I am not taken by surprise at anything that may occur here in court.

Mr. Bennett: I hope Your Honor will indulge us, and I say this for my brother counsel as well as myself that we are [998] both trying to get through. I may be more inept in presenting facts as I see them, but after all, both sides have given a great deal of time and study to this case and we are both endeavoring to bring the matter so the Court will have all the facts that will have a bear-

(Testimony of David Watt.)

ing on the theory of both sides which are not usual or simple.

The Court: I realize that, and that is the reason why I have given you generously of my time.

Mr. Bennett: I hesitate to take time in cross examining a witness if the Court feels such cross-examination is wholly beyond the point of the case the Court is interested in, or that I am proceeding in a method that is not consistent with the Court's desire.

The Court: My desires should be eliminated from the case.

Mr. Bennett: After all, you are the most important in this whole case because you have to decide it.

The Court: To be perfectly frank, and if I may comfort you or disappoint you, here is a case where both sides can take care of themselves in relation to their contract, in relation to their bookkeeping methods and I can understand how these difficulties arise. But it is beyond me to go into these items in the fashion we have been going into them and wasting the time you have. You can answer that by saying it is an unusual situation and it is a difficult situation and I realize that. [999]

That is the reason I gave you, as I have said, generously of my time here. But after all, there is nothing at all very mysterious about this case any more than any other case.

Mr. Bennett: Oh, no, I did not mean to infer there was anything mysterious about this case. I

(Testimony of David Watt.)

think it is a very justicable controversy and the Court can do the best it can with it.

The Court: I do the best I can under all difficulties here. Those things do not exercise me very much. I have no difficulty in finally determining these matters. I always invite counsel to protect the record so that in the event they are disappointed by me, they may have the record reviewed.

(Discussion between Court and counsel.)

The Court: We will adjourn this case until Tuesday morning, December 30, at 10:00 o'clock.

(Whereupon an adjournment was taken until Tuesday, December 30, 1947, at 10:00 o'clock a.m.)

Tuesday, December 30, 1947, 10:00 o'clock a.m.

The Clerk: Pacific Portland Cement Company vs. Westvaco Chlorine Products Company.

The Court: You may proceed, gentlemen.

DAVID WATT,
recalled.

Cross-Examination
(Resumed)

By Mr. Bennett:

Q. Mr. Watt, we have used during your examination as well as the examination of other witnesses, the terms "Direct charges" and "Indirect charges." So that we may have a complete understanding of what in your testimony you refer to as direct charges and what you refer to as indirect charges, I ask that you refer to Plaintiff's Exhibit 18. On

(Testimony of David Watt.)

the first page, under the title "Westvaco charges per book for cost of production to gypsum—Summary," you have listed direct charges; those direct charges that are in that summary refer to the direct charges listed under that title on the second page of this exhibit, do they not?

A. Well, these items were listed by the Pacific Portland as direct charges. In addition to these, I say that bittern is also a direct charge.

Q. All right, but let's get the record straight: Now, all of these items that are listed on page 2 of Plaintiff's Exhibit 18 under the title "Direct charges," namely, "Payroll, increase [1001] reserve, labor operations, labor repairs, workmen's compensation insurance, social security, taxes, materials and supplies operations, materials and supplies repairs, water power, gas, fuel oil," are considered by you and are referred to in your testimony now and hereafter as direct charges?

A. They are.

Q. Written in on this same page in this writing apparently are the words "Truck and tractor," and under that "Miscellaneous," you inserted those words, "truck and tractor"—

A. We did.

Q. (Continuing): ————didn't you, after you got this form from Mr. Flick?

A. We did.

Q. You consider that item "truck and tractor" as appears under the title page "Direct charges" as a direct charge?

A. We do.

Q. Will you explain just what that item is, Mr. Watt?

(Testimony of David Watt.)

A. The "Truck and tractor" item is the cleaning up—use of trucks and tractor in cleaning up around the gypsum plant.

Q. You only have a charge for that item for the period July 1, 1945, to June 30, 1946, is that correct?

A. Yes, that's correct—no, 1944 to 1945.

Q. No, we are both wrong. The only period from 1937 to June 30, 1946, where there is a charge for truck and tractor as a direct charge, is in the year July 1, 1944, to June 30, 1945, is that correct? [1002]

A. That's correct.

Q. There was some special situation that year, was there, which required the use of this tractor?

A. I would say so, yes.

Q. But you don't know of your own knowledge of that; you just assume that?

A. I just assume that, yes.

Q. Now, the "Miscellaneous" you have listed here in your own handwriting is also a direct charge and shows a charge only for the last year in question, namely, July 1, 1945, to June 30, 1946. Will you explain just what you mean or meant by the term "Miscellaneous"?

A. Well, by "Miscellaneous," here, is meant—you could not really apply it to "Material and supplies operations and repairs"—it was a miscellaneous charge.

Q. But a direct charge?

A. A direct charge to gypsum, yes.

(Testimony of David Watt.)

Q. It was not one of these so-called overhead or indirect charges that you simply allocated a portion——

A. No.

Q. But it was a direct charge that went into the manufacture of this gypsum?

A. That's right.

Q. But you don't recall just what it was?

A. I don't recall just what it was. [1003]

Q. All right. You say you also considered in addition to these items that appear on the second page of Plaintiff's Exhibit 18 under the title "Direct charges" that there are also other charges listed on that exhibit which you also consider direct charges for the manufacture or production of gypsum.

A. Yes, bittern to me is a direct charge.

Q. You consider that and you refer to that as a direct charge?

A. Yes.

Q. Now, what other items, if any?

A. "Supervision" is a direct charge.

The Court: Pardon me, was that "bittern"?

A. Bittern.

Mr. Bennett: Bittern.

The Court: That is the first time during the course of this trial that bittern has been mentioned in relation to charges.

Mr. Bennett: No, it has been mentioned several times.

The Court: It has been mentioned, yes, but not in relation to charges.

Mr. Bennett: The testimony of this witness

(Testimony of David Watt.)

shows they are making an arbitrary charge for bittern against the cost of gypsum.

Q. (By the Court): Break down that charge; give me more information about it, please. Is it disclosed there on that exhibit?

A. No, it is not. [1004]

Q. (By the Court): It is an arbitrary charge?

A. It is an arbitrary charge. The basis for charging bittern to the production at Newark is an arbitrary charge.

The Court: I understand that, but what is it based on? Is it just an arbitrary charge?

A. That is all we can say, your Honor, is that it is just an arbitrary charge.

The Court: All right.

Q. (By Mr. Bennett): Other than bittern, what other items on the summary or in this whole exhibit do you consider additional items of direct charge?

A. "Bittern, sulphuric acid, supervision."

Q. Now, you have considered and referred to "supervision" in your testimony heretofore as a direct charge. Where does that appear on this exhibit breakdown, Mr. Watt? That appears on the next to last page under the title "Bittern, insurance, taxes, depreciation, interdepartmental water, sulphuric acid and supervision." Now, just what is this item of "supervision" which appears on the calendar years July 1, 1944, to June 30, 1945, and the succeeding or last period, July 1, 1945, to June 30, 1946?

(Testimony of David Watt.)

A. The portion of the plant supervisors allocated to gypsum.

Q. Do you mean by that there is a plant supervisor and you allocate a portion of his salary to the gypsum operations?

A. Not one supervisor—all supervisors. We have a supervisor [1005] on every shift.

Q. You mean for your whole plant operation?

A. For our whole plant operation.

Q. They supervise the manufacture of these 40 separate products that are being manufactured?

A. Yes, including the gypsum.

Q. You take all of those supervisors and from their total salaries and wages you allocated certain portions to the cost of gypsum?

A. That is correct.

Q. The first time you attempted to do that was this period July 1, 1944, to June 30, 1945, is that correct?

A. That's correct.

Q. Prior to that time you did not allocate any part of this?

A. Prior to that time it was included in "overhead"—included as an indirect charge.

Q. Well, now, on what basis do you make this allocation of "supervision"?

A. It is allocated on an operating labor basis.

Q. It is allocated on an operating labor basis?

A. Yes.

Q. You mean the relation that the direct labor employed in the gypsum processing, the drying and grinding and shipping of gypsum bears to the di-

(Testimony of David Watt.)

rect labor involved in the manufacturing of these other 39 products? [1006]

A. That's correct.

Q. You don't keep a detailed breakdown by any time charts or time sheets showing the precise percentage of time these supervisors devoted to gypsum, do you? A. No, we don't.

Q. This, again, is what might be called the arbitrary allocation on the basis of labor?

A. That's correct. I might add it would be impossible for a supervisor in a plant like ours to keep records of this type.

Q. I daresay that would be true where you manufacture 40 products down there, as you testified. However, outside of those items that we have mentioned all of the other items of claimed charges or cost would be classed or considered under the category of indirect costs or charges, would they not?

A. That's correct, except shipping expense.

Q. The shipping expense you have listed in this exhibit involves both direct charge and a claimed indirect charge, isn't that correct?

A. That's correct.

Q. The direct labor involved in the shipping, that is, the handling of the gypsum after it is dried out and ground, pumping it into this big pump from the warehouse into the cars, and the direct labor involved in connection with handling the gypsum is listed as a direct charge?

A. Yes. [1007]

(Testimony of David Watt.)

Q. We went into that the other day.

A. Yes, you went into that the other day.

Q. Then you have assigned approximately a similar amount for charges that you say are allocated now on a tonnage basis which were formerly allocated on a value basis for general supervision in that shipping department, the supervisor and assistant, and so forth—all of those charges are called by you or classed by you as indirect charges?

A. Yes—miscellaneous shipping.

Q. Mr. Watt, these items of direct charges that appear separately under the title of direct charges on the second page of plaintiff's exhibit 18 are charges and costs that would not go on or exist if the production of gypsum were stopped or were not continued; that is a fact, isn't it?

Mr. Rosenberg: Which page are you on?

Mr. Bennett: The second page.

The Witness: Direct charges.

Mr. Bennett: Was there an answer to the question?

The Reporter: The witness said, "Direct charges."

Q. (By Mr. Bennett): Those charges and items listed under the title "Direct charges" on the second page of Plaintiff's Exhibit 18, beginning with "Payroll, increased reserve, labor operations, labor repairs" and so forth are charges, of course, which would not be incurred except for this manufacture of gypsum, isn't that correct? [1008]

A. That's correct.

(Testimony of David Watt.)

Q. (By the Court): What relation has the amount per ton to these figures?

A. This amount here?

Q. No, right here on top.

A. Your per ton figures are these various amounts divided by the number of tons.

The Court: That is what I thought. I wanted to be sure.

Q. (By Mr. Bennett): Now, I am passing over to the other page, where you have listed this item of "Supervision" which you first set up——

The Court: On the same page?

Mr. Bennett: No, your Honor, it is a latter page.

The Witness: It is the fourth page.

Q. (By Mr. Bennett): You state that this item of "Supervision" that you first set up as such an item of 1944-1945, is considered by you a direct charge, even though it is an allocated charge, is a portion of the general cost of supervision of manufacture of all of your 40 products: It is a fact, is it, Mr. Watt, that if gypsum were not produced there, that is, if there were no gypsum production, that cost of supervision, that is the total cost from which you have allocated this portion that appears on that page of Exhibit 18 would go on, nevertheless, would it not? A. It would. [1009]

Q. And in that sense it differs from these other direct charges and costs which would not exist if gypsum were not produced?

(Testimony of David Watt.)

A. That's correct.

Mr. Bennett: I might say at this juncture, your Honor, if I am not intruding on your Honor's present thought, that the court probably, in view of the maize or mass of figures involved in this case, will want this matter briefed when it is finally submitted, and especially we are going to try and speed up the cross-examination of this witness, and I did not intend to go into separate detail as to all of these matters. Obviously, if the court desires that, I would be very happy to do it, but I thought that covering the phases of the case as we best can with limited time we can probably be of aid to the court in analyzing these figures under our respective theories in such a way as will not involve a burden on the court in minutely examining the documents in the various details.

The Court: Is that agreeable, Counsel?

Mr. Rosenberg: That is agreeable.

The Court: Very well.

Mr. Bennett: It seems to me that is an efficient way to handle this and to be of aid to the court, and perhaps enable us to save time.

The Court: All right.

Q. (By Mr. Bennett): Now, Mr. Watt, the same thing as occurs in the case of this supervision item which you say the cost [1010] would go on whether or not gypsum was produced applies to all the indirect items, isn't that correct?

A. I would say so, yes, but at the same time if we did not stop production of gypsum it would be

(Testimony of David Watt.)

hard to say if we could lay off an engineer. It is impossible to say that.

Q. In other words, if you were to shut down your gypsum manufacture, just lock up this place where the gypsum is dried and ground and delivered, and stop the manufacture of gypsum, all these indirect items that you have allocated a portion to gypsum would go on and continue as costs and expenses of your plant, notwithstanding, wouldn't they? A. They would.

Q. And the same thing would happen as to this bittern, wouldn't it, Mr. Watt?

A. No, I don't believe so. If we stopped the gypsum department I believe we would not require as much bittern. [1011]

Q. As long as you make magnesium oxide and these 39 other products, you have to use bittern for that purpose?

Mr. Rosenberg: I object to the question as assuming a fact not in evidence. You are talking about magnesium oxide and 39 other products.

Mr. Bennett: I am sorry. I withdraw it.

Mr. Rosenberg: No. I want to finish my statement. You are trying to get something in here, squeeze it in. I want to make it.

Mr. Bennett: No.

Mr. Rosenberg: I object to the language you used, magnesium oxide and 39 other products. It is not magnesium oxide and 39 other products. It is a variation——

(Testimony of David Watt.)

The Court: Am I correct that all direct charges in this examination are explained in this——

Mr. Bennett: Your Honor recalls he says it is an arbitrary charge to bittern. We don't know, Your Honor does not know, and I don't know how that arbitrary charge is made. We consider it improper on any such basis or at all. The witness has stated to Your Honor that he considered it a direct charge and I wanted to find out from the witness if he knows or has an opinion on it.

The Court: Can you explain this item (indicating to witness)?

The Witness: Bittern, Your Honor, here, \$5794.88 or 16 [1012] cents and here, \$5854, 18 cents. In this period it actually showed a decrease and all the way through, the amount of bittern and the unit cost per ton.

The Court: That item of \$5,000.

The Witness: \$5794.88.

The Court: So it is an arbitrary charge. Why isn't it \$15,000 if it is an arbitrary charge?

The Witness: Because that would be charging too much to gypsum.

The Court: That is what I tried to develop here, it would be charging too much to bittern.

The Witness: This is way back to 1937, Your Honor; when they started off there was so much per ton for each product we made. It was 20 cents to gypsum and \$35 to dibromine, and 20 cents to gypsum and \$35 per ton to dibromine, and 55 cents to magnesia. These were arbitrary in the first place

(Testimony of David Watt.)

and they have gone on arbitrarily ever since, still on the same basis.

The Court: That is what I had in mind.

The Witness: I might add that gypsum is the product that gets the smallest charge for the bittern.

Q. (By Mr. Bennett): But in the meanwhile, you just considered this arbitrary allocation that you have mentioned? A. Correct.

Q. You have just carried that along?

A. Just carried that along. [1013]

Q. And you have the cents per ton allocated for bittern?

A. The gypsum changed when the bromine towers closed.

Q. When you stopped bromine operation you arbitrarily added a certain amount of the charge to gypsum?

A. The amount of bittern that went to bromine production was allocated equally on a percentage basis between magnesia and the others.

Q. After you stopped making bromine, manufacturing bromine——

A. It meant an increase per ton actually being allocated to the others and magnesia took most of it.

Q. Magnesia took most?

A. That is correct.

Q. Why did you give magnesia most of the cost of bittern?

A. As I said before, originally gypsum was 20 cents per ton, bromine \$35 a ton, magnesium to 55

(Testimony of David Watt.)

or 60 cents per ton. When we prorated the portion that went to gypsum, naturally the magnesium which was being charged at 55 cents would take a greater portion bearing on the charge for bittern.

Q. As a matter of fact, back in the period July 1, 1939, to June 30, 1940, that is one period and the charge for bittern was 10 cents and the next annual period, July 1, 1940, to June 30, 1941, you had a charge against bittern of 14 cents per ton.

A. That is so.

Q. Yet in the second period you produced a larger tonnage of gypsum than the first period. Do you know why that increase of [1014] 4 cents per ton?

A. I would say the pumping costs on bittern were higher than the relative ratios in the charges for maintenance.

Q. You mean that all through the years you have assessed against gypsum 20 cents—

A. The first year started at 10 cents, if I am right; I think it started at 10 cents rather than 20; for 1942 and '43 it increased to 20 cents.

Q. How many more times of the bittern expense today is charged against the magnesium rather than against gypsum; can you tell us that?

A. I believe there is a letter that Mr. Flick has there.

Q. Well, don't you know?

A. No. I would like to get the correct figures from that letter. Mr. Seaton gave you a letter, Mr.

(Testimony of David Watt.)

Flick, while you were at Newark once, showing the change in the allocation of bittern to gypsum.

Mr. Flick: I don't recall any letter.

Mr. Bennett: Let me see if we can get it this way.

Q. Is gypsum charged 5 per cent of the total cost of bittern?

A. That I couldn't give you until I see the figures.

Q. You don't know whether 5, 10 or 2 per cent?

A. No. I think it is more than that.

Q. Among these indirect charges which you say would go on whether or not gypsum was produced, appears the item of [1015] purchases and stores. Your Honor will find that on the second page of this exhibit. I don't think it is necessary to refer that to the Court. There is an item of purchases and stores. Note that the cost per ton of that indirect allocated item has increased since 1941 approximately six times.

The Court: Can you explain that?

A. Yes, I can, Your Honor.

The Court: Explain it.

A. In 1941 when things began to get so tough we had to increase our departments and get priorities and governmental reports and things like that and it nearly doubled our force in the personnel department and increased salaries.

Q. (By Mr. Bennett): In 1942 and during the war salaries were frozen at the same level.

(Testimony of David Watt.)

A. True, but I mean when you hire somebody new there was no freeze on his salary. You could pay him what you wanted.

Q. During the period from 1943 your plant has greatly expanded in all particulars than the manufacture of gypsum, has it not?

A. What particulars?

Q. Well, in the manufacture or development of these other 39 products that you produce down there.

A. I question it is so. I don't know. In what way?

Q. Haven't you developed new products and started new products during that period of time?

A. We have. [1016]

Q. A good portion of this particular item of overhead has been, in so far as it is increased is concerned, due to these other operations rather than the gypsum operation?

A. No, I don't agree with you at all on that.

Q. Mr. Watt, you produced in the period as early as 1940-'41 nearly as much gypsum as you produced in the last year shown here, 1945.

A. In 1941, 32,000 and up to around 36,000.

Q. During that time you say your purchases and stores, there was a rise of six times in that item in so far as the charge to gypsum is concerned. That has not been due to anything directly involved in the manufacture of gypsum?

A. It certainly has. It is as difficult to buy valves

(Testimony of David Watt.)

or piping or any supplies for the gypsum department as any other department in the plant.

Q. You mean each item of increase is directly proportioned to the cost of the gypsum department?

A. I do not understand that question.

Q. I understood you referred to this item of purchases and stores as an indirect item—that is one of the allocated items? A. It is.

Q. You allocated on some arbitrary basis of the relation to labor? A. That is correct.

Mr. Rosenberg: I object to that. The witness said [1017] overhead expense is allocated on a basis of what the labor in your gypsum department bears to the labor in the entire plant. Counsel repeatedly makes reference to the fact that that is an arbitrary——

Mr. Bennett: We contend it is, and I think accountants will contend it is. Merely because you don't like it——

Mr. Rosenberg: No, it is not. I object to this form of cross-examination.

The Court: I know the position of both sides. I understand that. I understand the theory of both sides on that, but I think we are wasting time if we continue on this line of testimony unless there is some particular thing.

Mr. Bennett: I will close in just a minute. Your Honor recalls this witness said that from these indirect items there were allotted, there was an increase of six times, so that actually the purchases and stores function that had anything to do with

(Testimony of David Watt.)

supervising the purchasing of materials and repairs for the gypsum department actually increased six times.

The Witness: I don't recall ever saying it. It bears the same relation to gypsum now as it did in the earlier days so, therefore, it did increase on gypsum.

Q. (Mr. Bennett): The actual cost of materials, valves and materials used in the gypsum plant are provided for in another part of your charge sheet, aren't they? A. Correct. [1018]

Q. Under direct charges?

A. Direct charges.

Q. This item in the purchases and stores merely has to do with the so-called overhead of the purchases and stores? A. Yes.

Q. In your plant at the time?

A. That is what it is, yes.

Q. Do you mean to say to this Court that the actual cost of—the time records were kept for the gypsum phase of that purchases and stores department, that it has increased six times since 1941?

A. I certainly would say it has increased six times since that date.

Q. Do you have any records or documents or evidence to support your statement?

A. Well,—

Mr. Rosenberg: Just a minute.

The Witness: I don't see how the fact—

Mr. Rosenberg: Just a moment.

Mr. Bennett: I am cross-examining the witness.

(Testimony of David Watt.)

The Court: One of the difficulties here is taking supervision, for example. There is no doubt that they don't keep books on just——

Mr. Bennett: I know that, Your Honor. I want to show, as I think the fact is, that where in 1941 they had the same [1019] amount of production and the actual cost, the actual stores that went to the gypsum plant are reflected elsewhere, not involved in this item at all, and it is absurd to contend that the actual gypsum part of this overhead went up six times or sixfold. The witness says it does and the thing I am directing to his attention—the witness can't prove that to be a fact.

The Court: Can you explain that?

The Witness: What the counsel is asking me is how many valves or how many pieces of pipe, how many different things we purchased for the gypsum plant and how much actual time the purchases and stores put into that. One specific kind of valve might take three days to purchase for the gypsum plant, but we don't keep time allocated on that. It is absolutely impossible. He is talking about the difference between 1941 and 1946. As I explained, in 1941 we had an increase which about doubled our purchasing department.

Mr. Rosenberg: Now, you were asked the question if you kept accurate time records, would it be six times. If we had accurate time records you would not allocate? A. No.

Q. The reason you allocate there is because you can't keep accurate time records so you must allocate it among the various products.

(Testimony of David Watt.)

A. That is true.

The Court: It is time to take a recess.

(Recess.) [1020]

The Court: You may proceed.

Q. (Mr. Bennett): Now, Mr. Watt, it is a fact, isn't it, that if other activities in your plant down at Newark in the manufacture of any of these other 39 products required a greater overhead and indirect plant charge or charges for these indirect items that under your system of allocating a portion of the overhead to gypsum would result in the gypsum being charged with an increase in such overhead; that is a fact, isn't it?

A. I don't get your question. Will you please read it again?

Q. Well, let us assume that the operations at your Newark plant in the production of products other than gypsum required or resulted in a greatly increased overhead and indirect charge of operation down there, one or all of the so-called indirect items that are listed in Plaintiff's Exhibit 18, by this method of allocating a portion of that increase of charges to gypsum necessarily resulted in an increase in the indirect charges allocated to gypsum; that follows, doesn't it?

A. No, I don't think you could assume that, at all. All of these overhead departments are for the whole of the plant.

Q. I know that. That is what you would call the so-called overhead burden, isn't it?

A. That is correct.

(Testimony of David Watt.)

Q. But supposing by reason of new products that you had developed, new methods of packaging or selling these products other than gypsum, your overhead had gone up five or six times over what it was in any previous period; this method that you found of allocating those charges would also impose an increase in the indirect charges allocated to gypsum, wouldn't it?

A. I don't think you could assume that, because it is not a fact.

Q. I am asking you to assume it, Mr. Watt.

A. I don't see how I could assume that.

Mr. Rosenberg: I object to that as pure conjecture.

Mr. Bennett: This is cross-examination, and I think the purpose is quite evident. If your Honor is not interested in that it may be a matter that perhaps is for argument. I won't press it with this witness, but I think it perfectly obvious that if plant overhead that may be caused or results from something having to do with any one of these 39 other products, or all of them together, and not due to gypsum, but nevertheless under this system of allocation on this direct labor basis or any other basis arbitrarily increases the so-called overhead charge made against gypsum.

Mr. Rosenberg: You are getting into the realm of pure conjecture and speculation, and there is no foundation.

Mr. Bennett: Of course, that is our position why

(Testimony of David Watt.)

these indirect charges should not be allocated in the first place, in that they involve pure conjecture.

Mr. Rosenberg: You are bringing the pure conjecture into this.

Mr. Bennett: I will try to finish as quickly as I can with [1022] this witness, your Honor.

Q. I want to ask you about all these allocated items on page 2 of this Plaintiff's Exhibit 18 which are listed as West Coast Items and starts in with:

“West Coast General Expense—West Coast General Supervision—West Coast Telephone and Telegraph—West Coast New York Office—West Coast Exploration—West Coast Subscriptions and Donations—West Coast Production Coast Control—West Coast Personnel Department—West Coast Group Insurance.”

Now, I notice from my computation of the exhibit that in the calendar year 1942 all of those items grouped together involve a charge of 10 cents per ton against gypsum as you allocated it according to your claim, and in the last period, July 1, 1945, to June 30, 1946, those items were increased to 19 cents per ton. I understood on your direct examination you to say that you at the Newark plant made these allocations other than that they were made either by West Coast headquarters or New York. Will you explain to the court how you at Newark allocated these West Coast claimed expenses that are listed in this exhibit?

A. These are all overhead accounts and are al-

(Testimony of David Watt.)

located to all products on an operating and repair labor basis.

Q. Did the New York office or West Coast headquarters allocate to the Newark plant a certain sum or charge for these various [1023] items that are listed here, such as "West Coast Exploration—West Coast Subscriptions and Donations"—

A. No, these are actual costs at Newark.

Q. What?

A. These are actual costs at Newark.

Q. You mean at Newark you accept the record of the actual subscriptions and donations that that plant made?

A. We certainly do.

Q. Why do you list them under "West Coast"?

A. I don't know. We don't list them so. This is listed by you as "West coast." These are not the names we carry those under.

Q. What do you mean by or what is your understanding of the figures you have given here under "West Coast subscriptions and donations"?

A. These are subscriptions and donations paid by the Newark office.

Q. Paid out by the Newark office?

A. Paid out by the Newark office.

Q. And you have allocated a portion of those subscriptions and donations to the cost of manufacturing gypsum?

A. Absolutely, as an overhead expense.

Q. What was your understanding of "West Coast General Expense" as it appears in this

(Testimony of David Watt.)

particular sheet, "Overhead and General Plant Expense"?

A. General expense incurred at Newark. [1024]

Q. Wholly unrelated to any other West Coast operation of your company?

A. How do you mean "unrelated"?

Q. I mean, does it involve solely the expense that was incurred at Newark, or is it an allocation of a portion of expense?

A. No, expense incurred in Newark for the Newark plant.

Q. It is not an allocated portion of the West Coast expense?

A. No, but I don't know what you mean by this "West Coast."

Q. As a matter of fact, in 1944, when Mr. Flick went down to see Mr. Cuneo, your superior, these titles were the titles carried on your books at that time—"West Coast General Expense"?

A. I certainly don't think so, because very seldom do we ever use the term "West Coast," and I know we never use "New York" the same as "New York" you have here. It might have been explained to Mr. Flick like that, but I don't remember where we ever had it on our books like that.

Q. Were you there when Mr. Cuneo explained to Mr. Flick how these accounts were set up?

A. No, I was not present.

Q. I beg your pardon?

A. No, I was not present.

Q. Take the title, "West Coast New York Office,"—what does that mean?

(Testimony of David Watt.)

A. That is the portion of the New York office expense that is [1025] transferred to West Coast.

Q. The New York office assigns to the West Coast a certain portion of its overhead, is that right?

A. A certain portion of its cost, I would say.

Q. The cost of running the New York office?

A. I would believe so, yes.

Q. Do you allocate that West Coast portion partly to the Newark plant and partly to the Chula Vista plant and partly to the Hollister plant?

A. That is correct, we do.

Q. That is done in your office?

A. That is done in our office.

Q. In other words, you allocate these New York administrative expenses——

A. We do.

Q. (Continuing): ——among the several plants of your company on the West Coast?

A. We do.

Q. And you allocated a portion of that West Coast total to the Newark plant?

A. We do.

Q. And you took a portion of that and allocated it to gypsum, is that correct?

A. Yes, that is correct.

Q. This item of "West Coast exploration," what is that, Mr. Watt? [1026]

A. West Coast exploration of mining and new mines.

Q. You mean mines down there in your plant at Newark, or mines somewhere else?

A. Mines anywhere on the coast.

(Testimony of David Watt.)

Q. Was that allocated to the West Coast operations by New York? A. No, it was not.

Q. That was an item that you allocated among the several plants of the West Coast operations of Westvaco, is that correct? A. That is correct.

Q. And yet you took and allocated a portion of the Newark plant's share of that West Coast exploration to the cost of producing gypsum, did you?

A. As an overhead, yes.

Q. Will you explain to me what in the world that exploration of mines elsewhere in the country can have to do with the production and manufacture of gypsum down here at this plant that is made out of bittern?

A. Certainly it is part of the plant burden at Newark and all products at Newark, and that should take a portion of it.

Q. And it is on that theory and basis that you set up this cost allocation of charges against the manufacture of gypsum, is it?

A. I don't understand that question.

Mr. Bennett: Will you read the question?

(Question read.) [1027]

The Witness: Will you read that again?

(Question read.)

A. I would say that for spreading the burden, spreading overhead, definitely that is the theory to spread it to all products in any given plant.

Q. You think there should be therefore made as a charge of the manufacture of gypsum sold to the Pacific Portland Cement Company that is made

(Testimony of David Watt.)

out of this bittern water, a portion of the charge that your company has for conducting mining explorations up in the mountains to add to the cost of manufacturing gypsum? A. I do.

Q. And you consider that is good accounting practice for by-products?

A. I certainly do.

Q. And you would say the same thing about the subscriptions and donations that you make down there?

A. I would say the same thing about all of these items.

Q. All of them? A. All of them.

Q. In other words, the same theory in your opinion would apply to the allocation of all of these indirect items?

A. All of the indirect items, yes.

Mr. Bennett: That's all, your Honor.

Redirect Examination

Q. (Mr. Rosenberg): Now, Mr. Watt, you testified that Mr. [1028] Cuneo was out here in 1945 and it was at his direction that you changed back your method of allocating general overhead. Do you recall that? A. Yes.

Q. In the course of conversation with Mr. Cuneo did he give you any instructions regarding allocation of indirect expenses in the shipping department? A. He did not.

Q. With reference to the bagging of the gypsum at Westvaco that the company retains for pharmaceutical, chemical and other purposes, that

(Testimony of David Watt.)

gypsum is bagged, is it? A. Yes.

Q. What size bags are used?

A. I believe they are 100-pound bags.

Q. Is any of the cost of packing that gypsum included in shipping expense?

A. No, it is not.

Q. So that Pacific Portland pays no part of that bagging operation? A. Absolutely not.

Q. With reference to the labor in the shipping department, are time card records kept of the direct labor employed in shipping magnesia on the one hand and gypsum on the other?

A. Direct labor, yes.

Q. So that would you say that any difficulties encountered in [1029] handling magnesia by reason of the fact that a portion of it is packaged, would that come within the direct labor in handling of that magnesia? A. It does.

Q. And would be charged directly to——

A. And would be charged directly to each product.

Q. There was some reference made to the fact that certain portions of the plant have been expanded since the time that this contract was entered into. Can you tell me whether there has been any expansion or enlargement of the gypsum plant?

A. There certainly has.

Q. Do you have a record of the extensions or enlargements made to the gypsum plant?

A. I believe it is attached to the answer to the interrogatories, isn't it?

(Testimony of David Watt.)

Mr. Bennett: It is Exhibit D, as I understand your inquiry.

Q. (Mr. Rosenberg): Referring your attention to Exhibit D, will you just enumerate the additions that have been made to the gypsum plant?

A. In June of 1944 an extension of the gypsum pumping system; in March, 1945, a new gypsum loading hose.

Mr. Bennett: Why not give the figures to save time, so I won't have to go into that, Counsel?

The Court: Give the figures.

A. Extension of the gypsum pumping system in June of 1942, [1030] \$661.54: New gypsum loading hose in March of 1945, \$173.38: Cyclone—gypsum drier, June, 1945, \$5328.62: Heater for the gypsum filter, December, 1945, \$270.15: Air cleaner—gypsum vacuum pump, December, 1945, \$330.07: Dry divider—gypsum drier, February, 1946, \$666.90: Carloading equipment, May, 1946, \$4989.96: Gypsum double panel mixer, September, 1946, \$1961.46: Total, \$14,381.38.

Q. In connection with the allocation of overhead, I believe you stated the overhead charged to gypsum is made on the basis that the direct labor in the gypsum plant there to the direct labor in the entire plant, is that correct?

A. That's correct.

Q. Also in the course of examination I asked you to explain why there appears to be a charge of 1 cent for fuel oil in the period from July 1, 1945, to June 30, 1946, and no charge in the preceding 12-

(Testimony of David Watt.)

month period, and you stated that you could assume why that was, but you had no accurate information. Since the time of that testimony have you made a check?

A. I did check and found that the gas was cut off at that time and we had to go over to fuel oil.

Mr. Bennett: We are not disputing that charge. It is not a matter in issue in this case, at all.

Q. (Mr. Rosenberg): With reference to these overhead charges, Mr. Watt, you were asked whether or not if we discontinued the production of gypsum those charges would continue anyway. [1031] Let me ask you, if we discontinued the production of magnesia and continued the production of gypsum would the same thing apply?

A. Definitely it would.

Q. In that event, would those indirect charges or overhead expenses continue, notwithstanding the discontinuance of the production of magnesia?

A. It would.

Q. Directing your attention to the summary sheet of Exhibit 18, and calling your attention to the fact that the bittern charge from July 1, 1944, to June 30, 1945, was 18 cents, and is only 16 cents in the same period, or a reduction of 2 cents per ton, can you explain how that reduction occurred?

A. The reduction in the second period is actually due to the fact that the higher cost of bittern was charged to magnesium products.

Q. You have stated that at the inception of these operations you determined a certain amount

(Testimony of David Watt.)

to charge to gypsum for bittern, and to bromine for bittern, and to magnesia for bittern, is that correce? A. That is correct.

Q. Throughout the years during the time that this contract has been in effect, and during the period that those products were being made at the Newark plant has the relative percentage of bittern charged to those three products been constant? [1032] A. It has.

Mr. Bennett: It seems to me that is contradictory to the last statement the witness made, Counsel. [1032-a]

Q. Directing your attention again to Exhibit 18, the page entitled, "Shipping Expense," to this figure of \$4859.99, that is the aggregate figure for the so-called allocated expense. Is there any question as to the accuracy of that figure?

Mr. Bennett: What figure is that?

Mr. Rosenberg: That is the figure you were calling for for the amount, the total of the allocated——

Mr. Bennett: I think that his answer would call for a conclusion and it is not proper redirect examination. The witness has already been examined both by you and by me with reference to that.

Mr. Rosenberg: I beg your pardon. I will challenge you to show any word of the transcript where I asked him about that figure.

Mr. Bennett: You asked him about all the figures in that sheet.

Mr. Rosenberg: No, I did not.

(Testimony of David Watt.)

The Court: He may answer. Let's get through.

A. (The Witness): There is no question about the correctness of it.

Mr. Rosenberg: That is all.

The Court: Is that all, counsel?

Mr. Rosenberg: Yes, Your Honor.

The Court: Step down.

Mr. Bennett: Your Honor does not want any more? [1033]

The Court: Proceed.

Recross-Examination

Q. (Mr. Bennett): You don't mean to say, Mr. Watt, that if you shut down manufacture of 39 other magnesium products and products of selling value of \$35 to \$80 a ton that you would continue to operate this plant merely to produce gypsum with all the overhead you would have?

A. I see no reason why we should not; why, we would cut the overhead down.

Q. In other words, you mean to tell the Court if you should suddenly decide not to manufacture magnesium products in any of these 39 forms or otherwise in which it is manufactured, that you would continue to operate that plant with all this overhead and all this charge merely to produce gypsum?

A. Mr. Bennett, that is not an accounting——

Mr. Rosenberg: Just a minute. I object to that as incompetent, irrelevant and immaterial. The only reason I asked that question was that Mr. Bennett, consistent with the completely illogical theory that

(Testimony of David Watt.)

they have on accounting, asked the witness if we discontinued gypsum, would the plant continue. There is no foundation laid as to whether or not if we discontinued gypsum we could continue making magnesium. It was asked purely for the purpose of demonstrating an accounting item, so I asked him the same question in a different form.

The Court: Magnesia instead of gypsum. [1034]

Mr. Rosenberg: Yes. But I submit there is no foundation laid and it would be completely irrelevant as to whether or not if this plant discontinued one product, it would be economical to continue making another.

Mr. Bennett: I submit it is perfectly proper. Your Honor will recall that four expert accountants stated one of the things to be considered in the character of a by-product was whether its operation would discontinue, if so, whether the other charges would continue notwithstanding, so that has some relevant basis. The only purpose I could see in counsel's question was to inject an element of argument or to have this Court believe that this plant would operate and continue to operate with this large overhead merely to produce gypsum. I thought I was entitled to that.

The Court: Let's get through with the witness.

Mr. Bennett: Q. You are still unable to tell us, Mr. Watt, the percentage of the total bittern cost to the Newark plant that is assessed against gypsum?

A. I believe it is 21 per cent as compared to 79 per cent assessed to oxides. These figures are

(Testimony of David Watt.)

not perfect. I am just mentioning these from my mind.

The Court: That is approximate.

A. That is approximate. That is the ratio.

Mr. Bennett: The value of the gypsum produced at the plant at Newark is about one-twelfth the value of the other [1035] products produced; that is also true, isn't it?

A. I don't know. I would have to check that. I mean, I can not guess at figures like that.

Q. I thought we agreed on that, Mr. Watt.

A. When did we agree on that, Mr. Bennett?

Q. The other day during your testimony.

A. I doubt if I agreed. You said you assumed that.

Q. Well, the record shows that is gone into, your Honor. Are your depreciation records kept at the Newark plant or are they kept at New York?

A. They are kept in New York.

Q. So the matter of allocating against gypsum the depreciation charge that you have set up is done in New York rather than being made at Newark?

A. It is not. It is done at Newark.

Q. I thought you said all the records—

A. The property records of the Newark plant are kept in New York but each month we receive an amount of depreciation which we allocate to the Newark plant.

Q. You mean New York simply advises you that you should depreciate the Newark plant so many dollars? A. Correct.

(Testimony of David Watt.)

Q. You take that direction made in New York and you allocate it down against your various products? A. That is true. [1036]

Q. Is the same thing true of taxes and insurance? A. It is.

Q. Will you again refer to Plaintiff's Exhibit 18 and turn to the second page, the third page, where you have listed, "Overhead and General Plant Expense." I direct your attention to two items which you have listed there for which you have a charge against gypsum, "Research," and "Research New Products," the total of which is set forth in the last period, July 1, 1945 to June 30, 1946 as being \$2622.63 or 7 cents a ton; the preceding period is \$1194.13 and shows a total of—that is a total of \$1194.13 or 3 cents a ton. You are claiming a four cent price increase with this claim of "Research and Research New Products" against cost of manufacturing gypsum. It is a fact, isn't it, Mr. Watt, that in the early period July 1, 1944 to June 30, 1945, you only had charged up to research in that period, up to December of 1944, the sum of \$9.98?

A. That is correct.

Q. Assuming that "Research and Research New Products" had anything to do with the manufacture of gypsum, that gives an erroneous result here as to any actual increase in the prorated cost of that item, does it not?

A. I don't get your question.

The Court: Explain those figures and the differential.

(Testimony of David Watt.)

The Witness: He mentioned a figure of \$9.98 up until December 1944, but this period goes from July 1944 to June 1945, [1037] so what has the \$9.98 got to do with the \$1194?

Mr. Bennett: That is a total charged for six months of only \$9. A. Correct.

Q. In other words, do you want us to understand now that you only allocated \$9.00 to the gypsum during that period of six months?

A. No. The \$9.98 was a direct charge to gypsum and all new products research for that period was done on a governmental research job and nothing was charged to any products at Newark.

Q. You mean you have a direct charge in that period of \$9.98 for research on gypsum?

A. To the gypsum plant.

Q. Do you know what that was for?

A. I definitely don't. It is charged by the research department directly to gypsum.

Q. In other words, the balance of that \$1194.13, is that a direct charge or is that likewise this indirect charge allocated?

A. Partly direct and partly indirect; partly new products.

Q. How much of it is direct and how much of it is other products than gypsum?

A. I can't tell from this sheet. That would have to be worked out separately.

Q. How long would it take you to ascertain that fact? [1038]

A. I would say about three or four days.

(Testimony of David Watt.)

Q. Didn't you have a conversation with Mr. Bannard when he was down at your plant about this very item? A. I did.

Q. You said to Mr. Bannard that an obvious adjustment would have to be made in that first period which would reflect a difference in the amount of any increase in these items of research and research for new products?

A. No. That was for the year 1945.

Q. Yes. A. Not 1944.

Q. You admitted to Mr. Bannard the figure that appeared in that particular item, you would have to make an adjustment to make it correct, didn't you? A. We did make the one—

Mr. Rosenberg: When Mr. Bannard was over there, Mr. Bennett, he was going over the items that showed an 82 per cent increase. This shows a 72 cent increase; the other was 88.

The Witness: 86.

Mr. Rosenberg: One of the items that was adjusted and resulted in this figure was the research item that Mr. Bannard and Mr. Watt discussed. Mr. Flick knows that.

The Court: Call your next witness. Let's get through with this case. Call your next witness. Step down. [1039]

WILLIAM K. WALLACE,

called by the defendant, sworn.

The Clerk: Will you state your name to the Court? A. William K. Wallace.

(Testimony of William Wallace.)

Direct Examination

Mr. Rosenberg: Q. By whom are you employed, Mr. Wallace?

A. Westvaco Chlorine Products Company.

Q. In what capacity?

A. West Coast manager.

Q. How long have you occupied that position?

A. Ten years.

Q. You are familiar with the operations of the corporation at the Newark plant, are you?

A. Yes.

The Court: Pardon me. Will you read that?

(The record was read.)

The Court: You are the manager?

A. Yes.

Q. Manager of the plant at Newark?

A. West Coast manager for all the western operations.

The Court: All right.

Mr. Rosenberg: Q. With reference to the magnesias you have produced at that plant, Mr. Wallace, is the greater part of it sold in bulk or in packages?

A. Approximately 80 per cent of it goes out in bulk, carload [1040] lots, 50 ton cars.

Q. The same as gypsum goes out?

A. I believe gypsum goes out in 40 ton cars in bulk.

Q. With reference to the bittern that is used in the processes over at the plant, can you state

(Testimony of William Wallace.)

whether or not from the time that this contract with Pacific Portland Cement was entered into, whether or not at the Newark plant the company has utilized and extracted all of the gypsum possible from all of the bittern purchased from the Leslie Salt Company?

A. Yes, sir, we have. We have removed all of the sulphate value from the bittern received from the salt companies; that has been removed as gypsum.

Q. Will you state whether or not at all times during the time that this contract has been in effect Westvaco has produced the maximum quantity of gypsum possible from the bittern that the company has had available?

A. That is correct. The production of gypsum is dependent on bittern deliveries from the salt companies and that is dependent upon the weather.

Q. On what? A. The weather.

Q. Is the same thing true as to magnesia? In other words, during all of this period has the plant at Newark utilized all of the bittern and recovered from all of the bittern the maximum amount of magnesia recoverable therefrom? [1041]

A. No, sir. The magnesia available in the bittern has not been required for production of magnesium; that is, all of it has not been required. Part of it is discarded in the Bay.

Q. Part of the bittern after the gypsum—

A. After the gypsum has been removed, part of the magnesia chlorides is returned to the Bay.

(Testimony of William Wallace.)

Q. Let me ask you, is any raw material other than from the bittern used in the production of magnesia at the plant?

A. Yes, a portion of the magnesia that we produce originates from the dolomite that we mine down at Hollister and part of the magnesia that is produced at Newark originates from magnasite that we mine in Nevada.

Q. There has been some talk about the fact that commencing as of a certain period you started to use dolomite over at the plant for the production of magnesia rather than lime; is that correct?

A. That is correct.

Q. Has the amount of dolomite in any wise affected the quantity of gypsum produced?

A. No. It has only affected the quantities of magnesia and not of gypsum.

Q. I will refer your attention to Defendant's Exhibit J which shows the quantity of magnesia and gypsum produced in the various periods which are involved in this case. Can you explain why the relation between magnesia products and gypsum products [1042] in the various periods is not constant?

A. I think that has been explained in the answers I have given before. Part of the magnesia originates from magnasite ore and dolomite ore and part of it from the bittern supply, whereas all of the gypsum originates from the bittern supply.

Q. So that the figures that occur on this sheet indicating the amount of magnesia produced, that

(Testimony of William Wallace.)

is not exclusively magnesia produced from bittern?

A. That is correct.

Q. Were you in court when Mr. Flick testified to a conversation that you and he had shortly prior to September 1, 1946, at which time you informed Mr. Flick that unless Pacific would pay the price that Westvaco asked or felt it was entitled to, Westvaco would discontinue the shipment of gypsum; do you recall that?

A. I was not present at that time, but I do recall the session that I had with Mr. Flick.

Q. You did have a conversation at or about that time with Mr. Flick? A. Yes.

Q. Was that over the telephone or—

A. That was a telephone conversation.

Q. What did you say to Mr. Flick in that conversation regarding discontinuing the shipment of gypsum?

A. Well, Mr. Flick, I believe, made the comment that we were [1043] dumping, or asked what we were going to do with the gypsum while they were not getting deliveries, and I believe in indicated to him that if it continued very long, we would have to dump it out in the flat.

Q. Did Westvaco in fact discontinue shipments of gypsum to Pacific Portland Cement Company on or about September 1, 1946?

A. Yes; we discontinued shipments September 1 for a period of about two weeks.

Q. At any time following September 1, 1946, did you have any conversation with Mr. Flick in

(Testimony of William Wallace.)

which you told him what you were doing with the gypsum during the period that no deliveries were being made to Pacific Portland Company?

A. No, sir.

Q. Did Westvaco in fact discontinue production of gypsum during that period?

A. We produced gypsum part of the period. We did make an installation of this panel mixer that has already been brought into the record, during that period the plant was down for a period of about five or six days to install the panel mixer.

Q. During the balance of the time—

A. During the balance of the time we produced gypsum.

Q. What was done with that gypsum?

A. We put it in the warehouse.

Q. At that time had Westvaco utilized the 4,000 tons that it was entitled to produce and retain for its own use under the [1044] contract?

A. No. We put that in storage for chemical uses.

Q. For your own uses under the contract?

A. That's right.

Mr. Rosenberg: Now, I might say, Mr. Bennett, that at your request I have here the records showing the production of gypsum during that period.

Mr. Bennett: Well, I would like to see it, counsel. I asked for them long ere this. Before you use them, I want to examine them.

Mr. Rosenberg: I am not going to use it.

The Court: Very well. We will take a recess and you can submit it.

(Testimony of William Wallace.)

Mr. Rosenberg: May I say this—

Mr. Bennett: May I look at these documents during the recess?

The Court: Yes.

Mr. Rosenberg: May I say this, your Honor: These consist of weekly reports consisting of three pages. On the last page it shows the sales that Westvaco has made of various products during the period. Now, I propose to detach the third page. It has no relevancy to the information that Mr. Bennett is seeking and it has the form of what we believe is confidential business information.

Mr. Bennett: Wait a minute. If it ties in with this, Mr. [1045] Rosenberg, I don't think—

Mr. Rosenberg: It does not tie in with the other information. It is merely a report of our sales during the period covered by the report.

Mr. Bennett: It think that may have a bearing on exactly what the witness has been testifying to.

The Court: We are not having any concern here about sales, are we?

Mr. Rosenberg: You want to know what was produced, don't you?

Mr. Bennett: Yes.

Mr. Rosenberg: All right. I will give you all the information you want on that.

The Court: Very well. We will take a recess until 2:00 o'clock.

(Whereupon an adjournment was taken until 2:00 o'clock p.m. of the same day.) [1046]

(Testimony of William Wallace.)

Tuesday, December 30, 1947, 2:00 o'clock p.m.

The Court: You may proceed.

(William K. Wallace resumed the stand.)

Direct Examination—(Continued)

Mr. Rosenberg: Q. Mr. Wallace, I show you reports which purport to be stock reports for Newark and Chula Vista plants for the week ending September 6, 1946, and the same for the week ending September 13, 1946, and the same for the week ending September 20, 1946. (Addressing the Court) I might say, your Honor, that counsel, Mr. Bennett, has inspected these. Mr. Wallace, are those the reports of the Newark plant showing the production among other things of the gypsum that is produced at the Newark plant?

A. Yes, sir.

Q. There is a column there entitled "Gypsum Produced," or words to that effect. Is all of that gypsum produced in the Newark plant, or do you produce gypsum in any other plant than the Newark plant?

A. No, it is all produced in the Newark plant.

Q. Will you state the amount of gypsum produced in the week ending September 6, 1946?

A. 279 tons.

Q. Will you state the amount of gypsum produced in the week ending September 13, 1946?

A. 262.2 tons.

Q. Will you state the amount of gypsum produced in the week ending September 20, 1946?

(Testimony of William Wallace.)

A. 445 tons.

Q. I believe you stated during that period of time the gypsum plant was down for repairs for six days. Can you tell me what period of time that six days covered?

A. From September 4 to September 9, inclusive.

Mr. Rosenberg: I will offer those in evidence as a group, if the Court please, as Defendant's Exhibit next in order.

Mr. Bennett: What about the last week? I think I asked for the whole month of September, counsel. Do you have the following week?

Mr. Rosenberg: Q. Do you have the report of the following week?

A. I didn't bring that. We have it in Newark.

Mr. Rosenberg: I thought you were interested in the period from September 1 to 13.

Mr. Bennett: I was interested also in the period for the balance of the month.

The Court: It may be admitted and marked.

(Report of production for weeks ending September 6, 13 and 20, 1946 was thereupon received in evidence and marked Defendant's Exhibit K.)

DEPARTMENT OF THE ARMY NO. K. Endorsed 7: Filed 11-30-47

PAGE 1.

From
Williams
Gilbert
Clinton
Kron-2
Hylan

Stark
Bradley
Dale
Martin
Cimino
Chapman Braman

STOCK REPORT - NEWARK AND CHULA VISTA PLANTS

Week Ending Sept. 20, 8:00 A.M., 1946

NEWARK		Opening Balance	Made or Received	USED		Shipped	Closing Balance
				Purpose	Quantity		
Unslaked Dolomite	Tons	822.55	45.40 403.56	Slaker	733.06		538.45
Quicklime	T	345.95	280.50	Hydrated Slaker	19.85 75.04		531.56
Hydrated Lime "A" Grade	T	2.60	** 20.20 24.00	M S		1.00	45.80
Hydrated Lime "B" Grade	T	9.25	* 2.50	M S			11.75
Perioliase #S-90	T	1406.14	372.99				1778.13
Perioliase #S-93	T	385.49					385.49
20 Mesh #S-90 and #S-93 Fines	T	80.25	49.12				129.37
2631-R, Bulk	T	48.05	17.55	Feed #2	27.47		38.15
Chloride Free MgO 2661 Bulk	T	152.78	82.06	Bagged	27.70		207.16
Chloride Free MgO 2661 Gran. Bag	T						
Chlor. Free MgO 2661 Powd. Bag	T	92.10	27.70	Rayon	50.00		69.80
Rayon Grade	T		50.00			50.00	
Quick MgO #2663 Bulk	T	131.75		Bagged			131.75
Quick MgO #2663 Gran. Bagged	T						
Quick MgO #2663 Powd. Bagged	T	.27					.27
				Dry Slaked Powdered	43.67 3.94 53.89		
Chem. Prop. MgO #2665 Bulk	T	234.68	79.84	Bagged			204.84
Chem. Prop. MgO #2665 Gran. Bag	T	32.92	53.89	2652-S	.93		68.72
Chem. Prop. MgO #2665 Pwd. Bulk	T		3.94	Bagged	17.17 3.94		
Chem. Prop. MgO #2665 Pwd. Bag	T	5.43	* 5.66	2652-S	11.09		
Chem. Prop. MgO #2665 Double Kill	T	6.65					6.65
#2662 Gran.	T	22.94	17.17			40.01	
#90 Perioliase Bagged	T	1.00					1.00
C-D Grade	T	6.75					6.75
#90 & #93 Fines Pwd.	T	22.20					22.20
#2665-M Pwd. Bag	T	3.57					3.57

NEWARK, N. J. CHULA YISTA PLANT

Aug 7.

Week Ending Sept. 20, 6:00 A.M., 1946

REMARK	Opening Balance	Made or Received	USED		Shipped	Closing Balance
			Purpose	Quantity		
#2641 Adsorptive Powdered	Lbs.	1807			4	1603
#2642 Adsorptive Powdered	Lbs.	7892				7892
#2652 Adsorptive Granular	Lbs.	9052	25,800			34,95
Sierra Oxychloride Bulk	Tons	90.50	224.46	Blend-Bag Gran.Bag	80.37 92.83	141.
Sierra Oxy. Granular Bagged	T	175.35	92.83			268.
Straight Oxy. Powd. Bagged	T					
Sierra Oxy. & #2665 Powd.Bag	T	507.70	167.64		280.56	414.
Gypsum, Bulk	T	508.20	445.00	Bagged Bag & Shipped for PFC	80.00 100.00 14.13	785.
Gypsum, Bagged	T	10.00	80.00		80.00	10.
Magnesia Sludge	T	337.35	578.80	Fed Kilns	547.54	329.
Bromine	Lbs.			Dibromide		
Ethylene Dibromide, Newark	Lbs.	115,770				115,7
Compressed Ethylene	Lbs.	2049	600		900	1759
Heptane	Gal.	81.50				81.
Kellstone Sleepers	Ft.					
Shell	Yds.	6257	1027	Quicklime	1626	5628
Sierra Crude Ore	T	1013.17		#6 Kiln	376.34	636.
Western Chips	T	333.35	101.77	#6 Kiln	204.26	231.
Heavy Fuel Oil	Gal.	146,171		#2 Kiln	51,038	95,1
Crude Dolomite	T	807.49	534.03		838.27	503.
CHULA YISTA Liquid Magnesium Chloride	Gal.			To Flare		
CHULA YISTA Flake Magnesium Chloride	T					

W

W Thom
Williams
M Gilbert
DClinton
Dixon-2
J Rylan
Wallace
Stark
Bradley
Dale
Martin
Cimino
Chapman Braman

STOCK REPORT - NEWARK AND CHULA VISTA PLANTS

Week Ending September 13, 8:00 A.M., 1946

NEWARK		Opening Balance	Made or Received	USED		Shipped	Closing Balance
				Purpose	Quantity		
Calained Dolomite	Tons	643.85	925.69	Slaker	746.99		822.55
Quicklime	T	363.94	--	Hydrated Slaker	15.75 2.24		345.95
Hydrated Lime "A" Grade	T	1.60	15.00	M S		14.00	2.60
Hydrated Lime "B" Grade	T	10.00	5.00	M S	5.75		9.25
Scumwater Periclase #S-90	T	1100.56	304.56				1405.14
Scumwater Periclase #S-93	T	384.23				1.26*	385.49
-20 Mesh #S-90 and #S-93 Fines	T	91.09	42.26			53.10	80.25
#2661-R, Bulk	T	113.87	2.50	Powd #2	68.32		48.05
Chloride Free MgO 2661 Bulk	T	60.70	92.08	Bagged			152.78
Chloride Free MgO 2661 Gran.Bag	T						
Chlor. Free MgO 2661 Powd.Bag	T	92.10					92.10
Quick MgO #2663 Bulk	T	131.75		Bagged			131.75
Quick MgO #2663 Gran.Bagged	T						
Quick MgO #2663 Powd. Bagged	T	.27					.27
				Oxy Blend Powdered #2662 Gr. Bagged	97.36 22.84 18.76		
Chem. Prep. MgO #2665 Bulk	T	183.49	#3 101.22 #4 88.93				234.68
Chem. Prep. MgO #2665 Gran.Bag	T	14.16	18.76				32.92
Chem. Prep. MgO #2665 Pwd.Bulk	T			Bagged			
Chem. Prep. MgO #2665 Pwd. Bag	T	5.43					5.43
Chem. Prep. MgO #2665 Double Mill	T	6.65					6.65
#90 Periclase Bag	T	1.00					1.00
C-D Grade Bag	T	6.75					6.75
#90 & #93 Fines Pwd. Bag	T	22.20					22.20
#2665-R Pwd. Bag	T	22.57					22.57
#2662 Gran Bag	T	22.84					22.84

(*) - Adjustment

STOCK REPORT - NEWARK AND CHULA VISTA PLANTS

PAGE 2.

Week Ending September 13, 8:00 A.M., 1946

NEWARK		Opening Balance	Made or Received	USED		Shipped	Closing Balance
				Purpose	Quantity		
#2641 Adsorptive Powdered	Lbs.	1617				10	1607
#2642 Adsorptive Powdered	Lbs.	7897				5	7892
#2652 Adsorptive Granular	Lbs.	297	8760			5	9052
Sierra Oxychloride Bulk	Tons	92.28	213.51	Blend-Bag Gran.Bag	131.49 83.80		90.6
Sierra Oxy. Granular Bagged	T	141.55	53.80				175.3
Straight Oxy. Powd. Bagged	T						
Sierra Oxy. & #2665 Powd.Bag	T	413.86	2665-97.36 Oxy-181.49			185.00	507.7
Gypsum, Bulk	T	284.00	262.20	Bagged Bag & Shipped for PPC	40.00		506.2
Gypsum, Bagged	T	10.00	40.00			40.00	10.0
Magnesia Sludge	T	440.68	591.35	Fed Kilns	660.68	54.70	537.3
Bromine	Lbs.			Dibromide			
Ethylene Dibromide, Newark	Lbs.	115,770					115,77
Compressed Ethylene	Lbs.	1789.00	300.00			50.00	2059.0
Heptane	Gal.	86.50				5.00	81.5
Kellestone Sleepers	Ft.						
Shell	Yds.	5230	1027	Quicklime			5257
Sierra Crude Ore	T	1329.23	56.01	#5 Kiln	372.07		1013.1
Western Chips	T	436.32	93.86	#5 Kiln	196.33		333.8
Heavy Fuel Oil	Gal.	199,328	50.66	#2 Kiln	48,071		146,17
Crude Dolomite	T	2307.01	450.48	#1 Kiln	1950.00		807.4
CHULA VISTA Liquid Magnesium Chloride	Gal.	141,550	13,400	To Flake	4,900		150,05
CHULA VISTA Flake Magnesium Chloride	T	41.75	23.75				55.5

AIR MAIL

Thoma
Williams
Gilbert
D. Linton
Dixon-2
J. Eylan
Salas
Stark
Bradley
Dale
Martin
Cimino
Chairman Brown

STOCK REPORT - NEWARK AND COLUMBIA VISTA PLANTS

Week Ending Sept. 6, 1946 8:00 A.M., 1946

NEWARK		Opening Balance	Made or Received	Purpose	Quantity	Shipped	Closing Balance
Calcined Dolomite	Tons	487.11	842.00	Slaker	686.26		643.85
Quicklime	T	389.52		Hydrated Slaker	25.58		353.94
Hydrated Lime "A" Grade	T	29.10	22.50	M S		50.00	1.60
Hydrated Lime "B" Grade	T	8.75	10.00	M S	8.75		10.00
Seawater Periclase #S-90	T	1087.58	163.00			150.00	1100.58
Seawater Periclase #S-93	T	434.23				50.00	394.23
20 Mesh #S-90 and #S-93 Fines	T	66.59				.50	91.09
#2661-E, Bulk	T	117.70	5.00	Fed	8.85		113.87
Chloride Free MgO 2661 Bulk	T	30.70	30.00	Bagged			60.70
Chloride Free MgO 2661 Gran. Bag	T						
Chlor. Free MgO 2661 Powd. Bag	T	92.10					92.10
Quick MgO #2663 Bulk	T	131.75		Bagged			131.75
Quick MgO #2663 Gran. Bagged	T						
Quick MgO #2663 Powd. Bagged	T	.27					.27
Chem. Prep. MgO #2665 Bulk	T	138.83	162.00	Oxy Blend Powdered Bagged	91.11 37.65		183.49
Chem. Prep. MgO #2665 Gran. Bag	T	65.59	5.61	To Bulk 2662	16.95 40.01		14.16
Chem. Prep. MgO #2665 Pwd. Bulk	T	--	37.65	Bagged	37.65		--
Chem. Prep. MgO #2665 Pwd. Bag	T	--	37.65	To 2662-S Research	11.81 .60	20.01	5.43
Chem. Prep. MgO #2665 Double Mill	T	6.65					6.65
20 Periclase Bag	T	1.00					1.00
20 Grade Bag	T	6.75					6.75
#90 & #93 Fines Prod. Bag	T	22.20					22.20
#2661-E Pwd. Bag	T	3.57					3.57
#2662 Gran. Bag	T		40.01			40.01	

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STOCK REPORT - NEWARK AND CHULA VISTA PLANTS

PAGE 2.

Week Ending Sept. 6, 8:00 A.M., 1946

NEWARK		Opening Balance	Made or Received	USED		Shipped	Closing Balance
				Purpose	Quantity		
#2641 Adsorptive Powdered	Lbs.	1617					1617
#2642 Adsorptive Powdered	Lbs.	7897					7897
#2652 Adsorptive Granular	Lbs.	297					297
Sierra Oxochloride Bulk	Tons	110.87	186.00	Blend-Bag Gran.Bag	159.19 35.40		92.
Sierra Oxy. Granular Bagged	T	106.15	35.40				141.
Straight Oxy. Powd. Bagged	T						
Sierra Oxy. & #2655 Powd.Bag	T	333.55	280.30			180.00	413.
Gypsum, Bulk	T	291.26	279.00	Bagged Bag & Shipped for PFC	150.00	84.28 50.00 42.00	284.
Gypsum, Bagged	T	--	150.00			120.00	10.
Magnesia Sludge	T	390.02	505.00	Fed Kilns	398.38	4.81 51.15	440.
Bromine	Lbs.			Dibromide			
Ethylene Dibromide, Newark	Lbs.	124,770				9,000	115,7
Compressed Ethylene	Lbs.	319.00	1500.00			30.00	1789.
Heptane	Gal.	86.50					86.
Kellestone Sleepers	Ft.						
Shell	Yds.	4,203	1,027	Quicklime			5,230
Sierra Crude Ore	T	1553.94	218.83	#5 Kiln	243.54		1329.
Western Chips	T	570.14		#5 Kiln	133.82		436.
Heavy Fuel Oil	Gal.	220,736		#2 Kiln	21,408		199,3
Crude Dolomite	T	3339.24	889.85	#1	1922.08		2307.
CHULA VISTA Liquid Magnesium Chloride	Gal.	132,750	18,900	To Flake	10,100		141,6
CHULA VISTA Flake Magnesium Chloride	T	50.75	32.00			41.00	41.

(•)-- Aug. ship. adj.

(Testimony of William Wallace.)

Mr. Rosenberg: Q. Mr. Wallace, will you state how many [1048] employees are employed at the Newark plant in the gypsum department in connection with the direct labor that is devoted to the processing and production of gypsum.

A. Four chemical operators—four men.

Q. Those are the men who perform the labor that is designated as direct labor on gypsum exclusively, is that correct? A. That's right.

Q. How many employees did you have in the magnesia plant performing direct labor that is charged as such in the magnesia department?

A. Thirty-two men.

Q. How many employees did you have in the plant performing maintenance or repair labor?

A. Forty-three men at the present time.

Q. How would their time be charged, do you know?

A. It is all on the time card basis.

Q. In other words, the work that they perform in connection with gypsum equipment is kept on a time card record and charged directly to gypsum?

A. That's correct.

Q. And the same is true of magnesia or bromine when you are making bromine?

A. That's right.

Mr. Bennett: As to that matter, counsel, we are not in any dispute in this trial as to the propriety of the direct [1049] charges of these maintenance repair men that are actually engaged

(Testimony of William Wallace.)

in time actually kept for anything having to do with gypsum.

Mr. Rosenberg: That's right.

Q. There had been some mention of charges made for so-called exploration. What does that represent?

A. The exploration work that we do at Newark—we have two mining engineers located there who direct exploration work on mining properties, such as dolomite in Hollister. We put on a private drilling campaign down there to explore a large deposit of dolomite which is a source of raw material for the Newark plant at the present time.

Q. Is that dolomite used in any way in the production of gypsum?

A. You couldn't produce gypsum without the calcium that originates in the deposit down at Hollister. That is where calcium originates for the gypsum.

Q. Does this exploration work involve exploration of any mining operations other than mining of calcium products?

A. Yes, it does; these two mining engineers who are located at Newark also do exploratory work on magnasite.

Q. Does the magnasite have any relation or function in the manufacture of gypsum?

A. Not in the manufacture of gypsum, but it does have to do with the production of all magnesia products at Newark. [1050]

Q. Now, also, there has been some mention of a portion of New York office expense allocated to

(Testimony of William Wallace.)

the Newark plant, the amount of which was allocated to gypsum in the period 1945-1946 was \$671. Have you been in the New York offices of the Westvaco Company? A. Yes, sir.

Q. What do they consist of?

A. The New York offices consist of four floors in the Chrysler Building.

Q. Do you know approximately how many employees they have there?

A. About 150 employees.

Q. Are you familiar with the provision of the contract which entitles Westvaco to retain up to 4,000 tons of gypsum processed at the Newark plant for sale by Westvaco for pharmaceutical, scientific and chemical purposes, are you?

A. Yes, sir.

Q. Now, does Westvaco in fact sell that gypsum for those purposes?

A. We sell some gypsum for those purposes.

Q. Is the gypsum that you sell for those purposes any different than the gypsum that is delivered to Pacific Portland Cement Company?

A. No, the gypsum for those uses all comes out of the same bin from which we take the gypsum for Pacific Portland. The only [1051] difference is part of the gypsum is put in bags and shipped out in 100 pound bags instead of shipping it in bulk, and there have been occasions when a portion of it was ground. That is the only treatment that gypsum gets.

Q. With reference to the plant additions that have been made to the gypsum plant as testified

(Testimony of William Wallace.)

to by Mr. Watt, can you state what the purpose was of those additions?

A. Most of the additions were for the purpose of increasing the capacity of the plant, the gypsum plant.

Q. There has been some mention of plant guards at the Newark plant, and the suggestion has been made that that was a matter of war necessity. Do you still have plant guards at the plant?

A. Yes, we have.

Q. Is that required under any contract or government regulation? A. No, sir.

Mr. Rosenberg: That's all. Oh, just one further question.

Q. When did you first start employing guards at the plant, do you recall?

A. Late in 1940.

Mr. Rosenberg: That's all.

Cross Examination

Mr. Bennett: Q. Now, these charts or forms which are Defendant's Exhibit K, for these periods ending September 20, there are types of gypsum listed. One is gypsum "bulk" and [1052] underneath that "gypsum bag." Why are they kept in different categories so far as the production figure is concerned?

A. The gypsum that is marked "gypsum bag" was chemical gypsum—what we call chemical gypsum for chemical or pharmaceutical purposes.

Q. The gypsum that you do or do not call "bag."

(Testimony of William Wallace.)

A. The gypsum that is called "bag" is used to designate that gypsum that we reserve for sale for chemical purposes or for pharmaceutical purposes.

Q. Gypsum which is manufactured for chemical or pharmaceutical purposes has to be freer from impurities and deleterious matter than the gypsum that is sold to Pacific Portland Cement Company for construction purposes, is it not?

A. Well, this gypsum that we produce at Newark is of such purity that every ton of it could be shipped out as Food Grade Gypsum.

Q. In other words, you produce your gypsum down there so that you can take out of any batch gypsum that will measure up to the purity requirements for chemical or pharmaceutical purposes, is that correct? A. That's correct.

Q. And you sell approximately 4,000 tons a year of gypsum to customers other than Pacific or for chemical or for pharmaceutical purposes?

A. That tonnage varies, I believe, between 2,000 and 3,700 tons [1053] in the last ten years.

Q. You get a higher price for that than you do for ordinary bulk gypsum that is used for construction purposes? A. Yes, sir.

Q. Did you actually ship to Pacific Portland Cement Company during this period from the week ending September 6 to the week ending September 13 any gypsum? A. No, sir.

Q. Well, take this first week of September. It seems, as I read these figures, that there are three

(Testimony of William Wallace.)

items of tonnage, 64.26, 50 tons and 42 tons that are under the column "Shipped." This is gypsum bulk?

A. That was shipped — some gypsum was shipped on August 31 to Pacific Portland. Nearly 100 tons were shipped on that day—two carloads.

Q. Where was this other ton, the amount in excess of the 100 tons of this total produced in that period shipped—to some other customer?

A. Possibly to one of the chemical accounts—bag material.

Q. You also show that you produced during that week 130 tons of bag gypsum and you shipped 120 tons of that out. Was that to your other pharmaceutical and chemical customers?

A. That's correct.

Q. The first time you began using this dolomite in the precipitation of magnesium oxide from the bittern water was when [1054] Mr. Wallace? When did you first start using dolomite down at your Newark plant?

A. I believe it was early in 1943, some time in 1943.

Q. And prior to that time you were using lime?

A. That's correct.

Q. Why did you change from the lime to the dolomite?

A. We were short of bittern. We were not receiving enough bittern from the salt companies to take care of the requirements and by substituting

(Testimony of William Wallace.)

dolomite for lime we were able to increase the output of our magnesium products.

Q. But by the same token you decreased the relative amount of gypsum produced, did you?

A. No, sir, the sulphate values were not available in bittern received from the salt works to produce any more gypsum.

Q. I want to call your attention to Plaintiff's Exhibit 18 of the summary sheet. It shows in the calendar year 1942 you produced 31,826 tons of gypsum, isn't that correct? A. That's right.

Q. The following year, the calendar year 1943, after you started using dolomite, your gypsum production was reduced to 24,431 tons, is that right?

A. That's right.

Q. The actual production of magnesia in that period increased, did it not, from 34,077 tons in 1942 to 37,671 tons in 1943?

A. I believe those are the figures. [1055]

Q. So you had in that comparative period a substantial increase in the total tonnage of magnesia produced and a consequent decrease of at least, approximately 23 per cent in tonnage of gypsum produced, did you not?

A. That is correct, and that is due entirely to shortage of bittern.

The Court: "Due entirely to the shortage of bittern," the witness said.

Mr. Bennett: Q. You mean the decrease—

A. In the gypsum.

(Testimony of William Wallace.)

Q. The decrease in the gypsum and the increase in magnesia was due to the fact that you brought in dolomite? A. Dolomite.

Q. And you have used dolomite ever since that time?

A. We have used some dolomite since then and here recently, a few months ago, we went to 100 per cent dolomite.

Q. But since you first started to use it in 1943, the principal agent that you had for precipitating the magnesium oxide in bittern water was dolomite?

A. That was the case in '45 and '46. We used small amounts of dolomite, but we were not running on 100 per cent dolomite.

Q. Now, 1943 you were desirous of stepping up and producing the very maximum amount of magnesia products that your plant was capable of producing, weren't you?

A. All of the magnesia products that we could produce, that's [1056] correct?

Q. And that continued for a period of time after that, didn't it, during the war years?

A. It went on through 1944 and part of 1945, yes.

Q. During that period of time when you were endeavoring to produce all of the magnesium oxide that you could, were you disposing otherwise of any of the magnesium chloride?

A. Yes, during periods when we were using dolomite we were disposing of magnesium chloride.

Q. The magnesium chloride contained magnesium oxide, didn't it?

(Testimony of William Wallace.)

A. Yes, but we didn't have plant facilities to process that tonnage. We could get more tons of dolomite sludge than lime sludge.

Q. You had to dispose of some of the magnesium chloride because of the limitation of your plant facilities to handle all the magnesium chloride that would—

A. We were interested in producing every ton of gypsum we could get out of the plant. That was the reason of disposal of some of the magnesium chloride.

Q. But when you had demand for magnesium chloride, magnesium oxide was your principal product, wasn't it, so far as dollar sales value was concerned?

A. The magnesium oxide was one of the main products.

Q. You received per ton for magnesium products at least 12 [1057] times what you receive for gypsum, don't you? A. No, we never have.

Q. Well, Mr. Watt stated here that the price per ton of magnesium oxide was, as I recall, 30 and some dollars per ton up to 60 or more dollars per ton, isn't that correct?

A. No, sir, the price for magnesium oxide varied, but when we are talking about the average return on magnesia products, it is at a much lower level than the figure mentioned in this court.

Q. What is the current quotation of magnesium oxide at your plant?

A. I am referring to the prices that were in effect in 1946, 1945 and 1944, the period under discussion.

(Testimony of William Wallace.)

Q. Yes.

A. At that time our average price was nearer \$30 than this \$60 figure that has been bounced around here.

Q. What is the price of just plain magnesium oxide down there in bulk?

A. We sell some down there for \$36, some for \$39 and some for \$42.

Q. That is sales on contract made at some previous time, isn't it?

A. No, those prices are adjusted now on a quarterly basis.

Q. What would you say the highest price magnesium produce per ton that you produce there is at this time? [1058]

A. We have some special magnesia products sold in small quantities to certain customers that bring in \$60, but that amount is small.

Q. The lowest price for magnasite at your plant now, for the crude product, is how much per ton?

A. We don't consider it a crude product. It is a high grade product and we have some of it going out at \$36.

Q. And it goes, then, in price from \$36 upward?

A. That's right, but the big tonnage is in the lower bracket.

Q. You mean the larger portion of it is \$36 per ton.

A. It is in the lower bracket. I think I indicated that the average price in 1944 and 1945 was nearer \$34 and \$30 than it was nearer \$46.

(Testimony of William Wallace.)

Q. Well, even so, that is at least ten times the value of the tonnage price of gypsum other than your pharmaceutical or chemical gypsum, isn't it?

Mr. Rosenberg: You mean the contract price, do you, Mr. Bennett? He is talking about market price. Are you talking about market price or contract price?

Mr. Bennett: You have no market, counsel, for this bulk gypsum that is not sold for chemical or pharmaceutical purposes except to us. As I understood, during those periods there was asked a price of \$3.76 a ton. That price would be approximately one-tenth or thereabouts of the price per ton of what the witness says is the average. [1059]

Mr. Rosenberg: Well, you have a convenient way of leveling off figures. I would say that \$3.76 per ton is not one-tenth of \$30. It is one-tenth of \$37.60.

Mr. Bennett: Well, he said \$36 was the average that he gave.

Mr. Rosenberg: No, it was not.

Mr. Bennett: Well, you and I differ apparently as to what the witness' testimony is.

Mr. Rosenberg: I think we should stay with the record on that.

Mr. Bennett: Q. How much bittern is required to manufacture a ton of dried and ground gypsum at your plant in the process you use down there at Newark? A. I don't have that figure.

Q. You don't know?

A. I don't know that figure.

(Testimony of William Wallace.)

Q. You have, do you not, a contract with the Leslie Salt Company whereby you take their entire output of bittern?

A. I would say we take most of it.

Q. Under a contract with them?

A. Yes.

Q. Unless you use all of the bittern that you are obligated to take from them, why, it would be a complete waste, wouldn't it?

Mr. Roesnberg: I guess anything you buy and don't use is [1060] a waste. I don't get the point.

Mr. Bennett: Well, the witness would know that.

Q. Any bittern you didn't use in the manufacture either of the various magnesium products or gypsum you would have to dispose of as a waste, wouldn't you?

A. I think we would store it for some future use.

Q. You are endeavoring to make some use of all of the bittern that you are required to receive under your purchase contract with the Leslie Salt Company, aren't you?

A. That's right. We are trying to find outlets.

Q. And the main purpose of this bittern so far as relative values is concerned, is used in the manufacture of magnesium oxide, isn't it?

A. Gypsum and bromine when we have a market for bromine.

Q. In treating the matter of allocation by this arbitrary method that Mr. Watt says that you

(Testimony of William Wallace.)

assign the cost of bittern to magnesia products and to gypsum, by far the largest portion of the cost of the bittern is assigned to the magnesia products, isn't it? A. Yes.

Q. So that you would say that the principal purpose and use of the bittern is in the manufacture of the magnesium oxide, isn't it?

A. I wouldn't say that because from year to year I have considered that the distribution cost of bittern has to be on the [1061] proper basis. I think we should take the constituent parts of that and charge it on the basis of sulphate content used in the gypsum.

Q. Well, coming now not to what you think should be done, but taking what you have done through the years, from the time the contract has been in operation up to now, so far as allocation of costs are concerned, you have considered magnesium is the principal purpose for which the bittern is purchased, have you not? A. Yes.

Q. All right. You can not manufacture magnesium oxide down in this plant, the way this plant is equipped, without using bittern, can you? In other words, bittern is the essential raw product with certain things added to it by which you make magnesium oxide? A. That's correct.

Q. I am directing your attention, Mr. Wallace, to a conversation which you had with Mr. Flick on or about the 6th of September 1946. Do you recall such a conversation in which the subject of your continued manufacture and delivery of gyp-

(Testimony of William Wallace.)

sum to Pacific Portland Cement Company was discussed?

A. Was it a telephone conversation? I recall a telephone conversation with Mr. Flick.

Q. Concerning that subject matter?

A. Yes. [1062]

Q. At that time did you tell Mr. Flick on the 5th of September — I said the 6th before — that there would be no gypsum production until Pacific accepted your proposal as to price and other conditions in future deliveries?

A. I remember that.

Q. And you stated that to Mr. Flick, did you?

A. There would be no more production for their consumption.

Q. Yes. At that time did you not tell Mr. Flick that you were pumping this calcium sulphate out into the Bay?

A. I believe he asked the question whether we were pumping it out into the Bay. I don't know whether he said, "into the Bay" or "into the flat," but in previous discussions I have always referred to pumping it into the flat, but in any event I believe he asked the question if we were pumping it into the flat, and I certainly would not have told we were pumping it out if we were putting it in the warehouse. I think I told him the time would come when we would soon have to pump it out into the flat. It would all depend on how long they were going to hold up payment on gypsum. If he had told me right then and there that they

(Testimony of William Wallace.)

were going to refuse to pay the price for three or four months, there was no question but that some of that gypsum would be pumped out into the flat. After our warehouse was full, we would have to do something with it.

Q. But you told him at that time you were pumping it out into the Bay? [1063]

A. No, sir, I did not.

Q. Didn't he ask you what you were doing with the gypsum?

A. I think he asked what we were doing with the gypsum, if we were pumping it out in the flat, or he may have said, "pumping it out in the Bay," and I told him the time would probably come when we would have to.

Q. And when that time would come you would still continue your operations of manufacturing magnesium oxide?

A. Will you read that question again?

(Question read.)

The Witness: A. Well, we had plans to produce a different product other than gypsum which would require a few months time in converting our equipment over.

Q. You mean to make a new product out of this sulphate that had to be taken away from the bittern water in order to produce magnesium oxide?

A. That's correct.

Q. Did you tell Mr. Flick you were proposing to do that?

A. Not in that conversation, but a few months prior to that I indicated to him research department was doing work which would lead to that.

(Testimony of William Wallace.)

Q. So you would stop the production of gypsum and make some other product—

A. That's right.

Q. Was some of the research that was involved in this project [1064] research that was allocated against the cost of gypsum by your plant down there?

A. It very likely could have been.

Mr. Bennett: That's all, Mr. Wallace.

Redirect Examination

Mr. Rosenberg: Just one question:

Q. Can you manufacture gypsum at the Newark plant without using bittern?

A. No, we can not.

Q. I may have asked you this, but will you state whether or not the reduction in the quantity of gypsum produced in 1943 as compared to the year 1942 was in any wise the result of or attributable to the use of dolomite in the magnesia process?

The Witness: Would you read that question, please?

(Record read.)

The Witness: The answer is no.

Q. Can you state this, whether or not in the year 1943 you utilized all of the bittern that was available from the Leslie Salt Company in the production of the maximum amount or quantity of gypsum that could be recovered therefrom?

A. Yes, we did.

Mr. Rosenberg: That's all.

The Court: Call your next witness.

Mr. Bennett: If your Honor please, counsel has agreed we may put on out of order Mr. Colton. He is a resident of Reno [1065] and has business up there. He is the gentleman referred to in Mr. Barrows' testimony and I would like to put him on for three or four questions.

The Court: Very well.

JAMES H. COLTON

called as a witness on behalf of plaintiff in rebuttal out of order, sworn.

The Clerk: Q. Will you state your name to the Court? A. James H. Colton.

Direct Examination

Mr. Bennett: Q. Mr. Colton, you are the Mr. Colton who was vice president in charge of operations for Pacific Portland Cement Company in the years 1936-1937 with whom the negotiations were conducted with Mr. Barrows relative to the purchase by your company and the sale by Mr. Barrows' company, the California Chemical Corporation, of certain gypsum, and which culminated in the contract which is involved in this case, January 29, 1937? A. That is correct.

Q. State whether or not at any time before or after you received Mr. Barrows' letter of June 5, 1936, which is in evidence in this case and is a letter of September 18, 1936, with the accompanying draft of agreement which is also in evidence here, and up to and including the time of the contract of [1066] January 29, 1937 was actually executed, Mr. Barrows or anyone else representing

(Testimony of James H. Colton.)

the defendant, stated or in any way suggested to you that any price increase over the stated price of \$2.80 per ton should be based on any items other than direct costs of the manufacture of gypsum?

A. No. [1066-A]

Q. Did Mr. Barrows, at any time during your negotiations with him ever state to you, or did you state to him, that you would insert in the contract the words "Cost of production," and leave that up to the accountants to determine what those costs were? A. My answer would be no.

Q. Now, Mr. Colton, from the date of this contract in January of 1937 up until the time that the defendant notified your company of of the second price raise, did anyone representing either your company or the defendant ever say or suggest to you in any way that the defendant claimed or was claiming the right to increase the price for gypsum under the contract, based on any increase of indirect overhead items of cost?

A. They did not.

Mr. Bennett: You may take the witness.

Cross Examination

Mr. Rosenberg: Q. Mr. Colton, you negotiated this contract with Mr. Barrows, did you?

A. Up to the time it was submitted to the attorneys.

Q. Nobody else took any part in the negotiations but you, yourself?

A. That's right; I negotiated the contract. The final draft was left in the hands of the attorney. I negotiated; I with Mr. Barrows.

(Testimony of James H. Colton.)

Q. And nobody else on behalf of your company had anything to do with those negotiations, did they? [1067] A. That's right.

Q. When did those negotiations start?

A. Well, the actual negotiations got going sometime in the middle of '36. We had had conversations over a long period of time, the exact date I couldn't state; but I had known Mr. Barrows, and during the time that he was experimenting at Westvaco or at Newark, at various times he had talked to me, and I don't think we got to the point of discussing a contract until probably in the middle of '36.

Q. Up to that point your discussions were purely casual? A. Very general.

Q. Were preliminary, were they?

A. Very general up to that time.

Q. They continued until when? Until sometime in September, 1936, isn't that correct?

A. That is right.

Q. At about that time you suggested to Mr. Barrows that he submit to you a draft of what he had in mind, isn't that right?

A. That is correct.

Q. And at that time you were considering a contract involving the purchase of oyster shell by Westvaco from Pacific, and the sale of gypsum and lime by Westvaco to Pacific, is that right?

A. That's right. They were considering purchasing shells from us, and we were to buy lime and gypsum from them.

(Testimony of James H. Colton.)

Q. Then under date of September 18, 1936 you received a [1068] letter from Mr. Barrows, which is in evidence as Defendant's Exhibit H, did you (showing paper to witness)?

A. I think that is right. Without comparing it, I think that is right.

Q. Enclosed with that letter was a form of agreement which covered the draft of agreement providing for the purchase of oyster shell by Westvaco from Pacific and the sale of gypsum and lime by Westvaco to Pacific, is that right?

A. That is correct.

Q. And then did you have any further discussion with Mr. Barrows after this letter was received by you?

A. I think the only discussion Barrows and I had after that pertained to the specifications.

Q. But your recollection is that you did not have any further conversation with Mr. Barrows regarding any of the provisions of this transaction other than the specifications, isn't that correct?

A. I don't recall what we discussed other than the specifications.

Q. You don't even recall having any conversations with Mr. Barrows after September 18, 1936, do you?

A. I am sure he did talk to me after that time, but just how many times, I don't know.

Q. Do you recall now that you did have conversations with him?

A. Yes, I am sure we discussed the specifications after that. [1069]

(Testimony of James H. Colton.)

Q. Just the specifications?

A. I am sure we did that; I can't say what else.

Q. Did you discuss anything else?

A. I don't recall it.

Q. Do you recall that you had any conversation with Mr. Barrows other than the one relating to the specifications?

A. Oh, I had a number of conversations with him.

Q. You did?

A. At different times, but as to trying to fix the dates in my mind, I can't do it without reference to something else.

Q. Do you remember when your deposition was taken on October 24, 1947, and at page 19, line 24, I asked you these questions and you gave these answers:

“Q. Now, following the receipt of that letter, Mr. Colton, when was the next time that you met with Mr. Barrows for the purpose of discussing this contract?

A. Well, sir, I couldn't tell you whether I met with Barrows again—

Mr. Rosenberg: What is the answer?

(Answer read.)

The Witness: With reference to the contract.

Mr. Rosenberg: Q. You have no recollection of any meetings or discussions with Mr. Barrows subsequent to September 18th, 1936?

A. You are talking about verbal discussion now? Is that your question, whether I verbally discussed the contract [1070] with him afterwards?

(Testimony of James H. Colton.)

Q. Yes.

A. I can't name any time that I verbally discussed the contract with him afterwards.

Q. Now, did anyone else on behalf of Pacific carry on the negotiations toward— A. No.

Q. Let me finish the question, please.

A. All right.

Q. —toward the ultimate execution of the contract, other than yourself, after this date?

A. Not so far as any verbal conversations are concerned that I know of.

Q. Well, through what medium were the negotiations carried on from this point?

A. Then it is my belief that the outline of the contract which was presented with Mr. Barrows' letter was received by me, discussed with the other officials of your company"—

The Witness: "Our company."

Mr. Rosenberg: "Of our company," pardon me—"and certain paragraphs were marked to stay in the agreement as is, or as drawn; certain changes were to be made in a paragraph, or a paragraph was to be rewritten entirely; and the draft or agreement which Mr. Barrows sent to me was then sent to our attorneys for redraft. I can't be positive [1071] whether it went back to Barrows before it went to the attorneys or afterwards—I can't remember that, but the actual fact is that after it was redrafted—I am not positive that Barrows and I discussed it, because he went east, and I think Williams came up to see me once or twice,

(Testimony of James H. Colton.)

but it was in connection with signing the agreement rather than for a discussion of the terms or conditions or anything of that sort. It was relative to the final execution of the agreement.

Q. Now, the agreement is dated January 27th—" Then Mr. Kaapcke corrected me, "29th, isn't it?" and I say, "Yes, January 29th, 1937."

"Q. Between September 18th, 1936, and the date of the execution of the contract how were the negotiations between the companies carried on which resulted in the ultimate contract?

A. It seems to me I have just gone over that with you as near as I know how to do it.

Q. Well, you stated that you and your fellow officials of Pacific made certain recommendations with reference to the draft that had been presented by Barrows?

A. And we rewrote it and sent it back to the California Chemical Company either by letter or in person; I don't remember.

Q. When you say "we rewrote it," you mean your attorneys? [1072]

A. I mean our attorneys did.

Q. And then was the contract executed in the form that it had been rewritten by your attorneys, or were there further changes made?

A. I don't recall."

Mr. Bennett: Why don't you go on and read the next?

Mr. Rosenberg: I can read the whole thing.

Mr. Bennett: Well, I think that, having read that much, you ought to read the next.

(Testimony of James H. Colton.)

Mr. Rosenberg: (Reading):

“Q. You don’t recall?

A. There might have been some changes back and forth, but I don’t recall. My files didn’t show it, so I don’t know.

Q. And between September 18th, 1936—

A. You say September. I haven’t named September definitely. I said the latter part of 1936, in my opinion.

Q. Well, I am mentioning September 18th as being the date of Mr. Barrows’ letter to you.

A. Oh, that is it. All right.

Q. So between September 18th, 1936, and the date of the execution of the contract did you have any correspondence with Mr. Barrows or the California Chemical Company regarding the terms of this proposed agreement?

A. I had no correspondence with him that I recall.

Q. So your best recollection is that you took the draft [1073] prepared by Barrows, you and your fellow officers suggested modifications and submitted it to your attorneys and they redrafted the agreement and sent it to Barrows, and the agreement was signed in that form?

A. That is my opinion.”

Was that testimony correct? A. Correct.

Q. But you don’t have any recollection, do you, of any conversation with Mr. Barrows between September 18, 1936 and January 29, 1937?

A. No, I have no recollection of the time.

(Testimony of James H. Colton.)

Q. Let me ask you this, Mr. Colton—and I am referring now to the draft of agreement that is attached to Mr. Barrows' letter of September 18, and to the provisions of paragraph 6 of that draft, which states:

“6. The prices hereinabove stipulated to be paid by Pacific for gypsum, quicklime and hydrated lime are based upon the average direct cost to California to produce the materials covered by this agreement during the first year's operation of the contemplated new plant proposed to be erected at Canal Head, Newark, California, and it is therefore understood and agreed that in the event of price advances and labor, transportation, fuel or supplies resulting in an increase of 5% or more in cost above the first year's average direct cost hereinabove referred to, [1074] f.o.b. cars shipping point, then and in that event California shall have the right to increase the price to Pacific to the extent of the increase above the said average direct production cost for lime or gypsum.”

You read that paragraph when you got that agreement, didn't you? A. Certainly.

Q. And you knew that that paragraph provided that the California Chemical Company would be entitled to a price increase only in the event and to the extent that their direct charges increased, did you? A. Yes.

Q. Now isn't it a fact that that paragraph was changed at the insistence of Mr. Barrows? You certainly didn't suggest any change in that paragraph, did you?

(Testimony of James H. Colton.)

A. That contract was changed by the attorneys in consultation with your attorneys, and I really don't know just how it was arrived at.

Q. You are certain that you did not suggest it?

A. I did not suggest it, no. My understanding was that it was going to stay that way. Until it was changed I did not know there was to be a change. I didn't discuss it with Mr. Barrows.

Q. But you certainly would not have suggested, Mr. Colton, that "direct charges" in the above language, you merely put in [1075] "cost of production" in the contract; you would never have suggested that?

A. I would have preferred to have it stay as it was, but still it might mean the same thing to an operating man, and does yet.

Q. What is that?

A. It still might mean the same thing to an operating man and does yet.

Q. At any rate, you are certain that that change in the contract was not made at your suggestion, was it?

A. I didn't suggest it, no.

Mr. Rosenberg: No. That is all.

The Court: Step down.

Mr. Bennett: Just one more question. Counsel asked about a discussion. I think, your Honor, it might be well to call the witness' attention to a further portion of this deposition with reference to the discussion of specifications.

Redirect Examination

Mr. Bennett: Q. Turn to page 26, Mr. Colton, if you will, please.

(Testimony of James H. Colton.)

Mr. Rosenberg: What page?

Mr. Bennett: Page 26, line 10.

“Q. Now directing your attention to paragraph 5 of the contract, do you recall any specific discussion relating to the provisions of that paragraph? [1076]

“A. Yes, that paragraph was discussed at the time with Mr. Barrows, at the time I told him the specifications that we were going to ask for, and it was entirely satisfactory to him.

“Q. That is, the specifications?

“A. There was no argument on the specifications or argument on the fact that we were to either accept or reject, as set forth in this clause here. It was perfectly satisfactory to him. He thought he would have no trouble at all in meeting it, and didn't bother; he said his stuff was all going to run higher than 97.5 anyhow.”

That testimony was given by you at the time your deposition was taken?

Mr. Rosenberg: Just a moment. May I ask the purpose of that question? What does it have to do with the direct testimony?

Mr. Bennett: Simply this, counsel, and I think it is perfectly clear: The witness stated that after he received this draft of Mr. Barrows' letter of the 18th of September, he had a discussion with Mr. Barrows with reference to the specifications as provided for in this paragraph 5 or in relation to paragraph 5 of the Barrows' draft.

(Testimony of James H. Colton.)

Now, you read a portion of his deposition apparently for the purpose of negating the fact that the witness did have such discussion with Mr. Barrows. What I wanted to show is [1077] that in the deposition which you took of the witness, the witness stated at that time that he had this discussion with Mr. Barrows as to the specifications for the gypsum.

Mr. Rosenberg: And he doesn't say that it was after September 18, 1936.

Mr. Bennett: Oh, I think so, because, obviously, that is it. You handed him a document, this document that accompanied Mr. Barrows' letter of the 18th of September.

Mr. Rosenberg: Oh, no, Mr. Bennett, please, now; the document that I handed to this witness in the deposition is the contract that was ultimately executed, and I asked him about conversations that he had about paragraph 5, which is the paragraph relating to the specifications, moisture, credit for lower gypsum content; so you are just all tangled up, I think.

Mr. Bennett: No, I am not tangled up a bit, counsel. Paragraph 5—where is the Barrows draft?

Mr. Rosenberg: That's right; that is the agreement you have got there.

Mr. Bennett: You will see I am not tangled up.

Mr. Rosenberg: Show me anything about the specifications in that paragraph.

Mr. Bennett: Well, the specifications apparently do appear, your Honor, in this paragraph 5 of

(Testimony of James H. Colton.)

the main contract, that is, the contract that was finally executed. [1078]

The Court: I read it.

Mr. Bennett: My statement—

The Court: I just read it; I couldn't follow it.

Mr. Bennett: Yes, your Honor; and my statement that he was referring to paragraph 5 of the Barrows draft apparently is incorrect, but that is wholly immaterial. The point is that the witness was asked on his cross examination as to whether he had any discussions with Mr. Barrows with reference to specifications, and he did relate at the time his deposition was taken the discussions that he had with Mr. Barrows with reference to the specifications that appear in the contract.

Now, without taking the time to read the Barrows' draft through in full, I am not prepared to state all the specifications, if any, appeared in that contract.

Mr. Rosenberg: They don't.

Mr. Bennett: In that draft. And apparently counsel is right now in saying that there isn't anything in the 18th of September draft submitted by Mr. Barrows that had to do with specifications. But as I recall the witness' testimony on direct, he did state that after he received this draft, or some time in connection with it, he did have a discussion with Mr. Barrows about the specifications. And my sole purpose in reading this portion of the deposition was to show that at the time his

(Testimony of James H. Colton.)

deposition was taken, that was gone into and the witness was interrogated at some length with reference to that [1079] subject matter.

Mr. Rosenberg: Anything further?

Mr. Bennett: That is all.

Mr. Rosenberg: No further questions.

The Court: Step down.

We will take a recess.

(Recess.)

[1080]

Mr. Rosenberg: Do you want to put that in?

Mr. Bennett: I haven't looked at it yet. I can look at this—

Mr. Rosenberg: I would like the record to show, if the Court please—the other day when Mr. Melhase was on the stand, Mr. Bennett asked if he could bring in a report that was made on that test—I have turned the report over to Mr. Bennett.

And also you asked, Mr. Bennett, for the quantities of ethylene dibromide produced during the various periods in question. I have those figures. If you want them, they are available to you.

Mr. Bennett: May I have that sheet that you have here (document handed to Mr. Bennett).

FRANCIS P. FARQUHAR,
called as a witness on behalf of defendant; sworn.

The Clerk: Your name?

A. Francis P. Farquhar.

Direct Examination

Mr. Rosenberg: Q. Mr. Farquhar, what is your business or profession?

(Testimony of Francis P. Farquhar.)

A. I am a certified public accountant in public practice.

Q. And since when have you been a certified public accountant?

A. By examination in 1917; I believe my certificate is dated [1081] back in '18.

Q. Will you give us a brief outline of your accounting experience since the time that you became a C.P.A.?

A. At the time I became a C.P.A. I was a lieutenant in the United States Naval Reserve, what was then the pay corps, and was cost inspector for the Navy at the Union Iron Works, Bethlehem Shipbuilding Corporation. I had been in practice employed prior to that time. After having been relieved of active duty in the Navy I was employed in San Francisco with a firm of public accountants for about two years, and then in 1922 I opened my own office and have been in practice under my own name or with partners associated with me since that time continuously.

Q. And in the course of your practice as a certified public accountant, have you had occasion to inform yourself and has your practice related to manufacturing costs and accounting?

A. Yes, I have had a considerably varied accounting experience. In fact, in the earlier stages of my professional work I was engaged very largely in industrial accounting in Boston, and later in San Francisco, working under the late Clinton H. Scovell, who was one of the recognized leaders in

(Testimony of Francis P. Farquhar.)

industrial cost accounting, and had an association with C. V. Wellington, who is now the head of Scovell, Wellington & Company, in New York and other Eastern cities, and I felt that I was very well educated in the fundamentals of cost accounting through [1082] association with them, and later here in San Francisco. Since then I have had a varied practice.

Q. And do you have any affiliation at the present time with that firm?

A. Yes; ever since I opened my own office, I have represented Scovell, Wellington & Company on work for their clients on the Pacific Coast, and have done—occasionally we do the entire work under the name of Scovell, Wellington & Company, so we have a close continuous affiliation with that firm.

Q. And their business is primarily industrial accounting, is it?

A. It is a general accounting practice, but rather more predominantly industrial accounting than most of the other large firms.

Q. And what societies or institutions are you a member of?

A. I am a member of the American Institute of Accountants; I am a member of the California Society of Public Accountants—Certified Public Accountants, of which I have been president; and I have been a member of the National Association of Cost Accountants practically since its inception in 1920.

Q. Now, Mr. Farquhar, I am going to ask you to assume that a chemical plant is recovering from

(Testimony of Francis P. Farquhar.)

a common raw material three different products, which we will designate as products A, B, and C, and I will ask you to assume that product B is technically a by-product in the sense that it consists in part [1083] of a chemical element which must be extracted from the raw material in order to produce product C in a pure and salable form. Assume also that in order to convert part of B into a salable commercial product after it is separated from the raw material, it is necessary to process it, and that for that purpose it is necessary to have a physical plant devoted exclusively to such processing, and it is likewise necessary to employ labor which devotes itself exclusively to this processing. And assume further that by reason of contract it is necessary that the manufacturer determine the cost of production of product B. Will you state, in your opinion, whether under these circumstances it is proper and good accounting practice to include in the cost of production of product B a portion of the overhead of the plant?

A. If overhead is what I consider the generally accepted definition, I would say that you cannot obtain true costs of any production without some portion of the overhead, because the line of distinction between direct costs and overhead is an artificial one, largely a practical matter; that costs must include all the elements that go into it, and one of the elements that goes into the production is the group of things that are generally classified as factory overhead.

(Testimony of Francis P. Farquhar.)

Q. And under the same assumed circumstances, will you state whether or not, in your opinion, it would be proper and good accounting practice to include in the cost of production of [1084] product B a portion of the indirect charges of the plant, such as general superintendence and other charges for labor which are devoted to the production of the several products manufactured in the plant, including product B, but as to which it is impossible or impracticable to keep records of the time devoted exclusively to each particular product.

A. Well, it is the general nature of overhead that you cannot keep a minute and accurate account of it; that you have to use some devices for allocating it, and it exists; and therefore, to get sound costs, you must absorb that overhead in the various products. And I think that, as I understand, Product B is something that, as you call it a by-product, but if it takes any further processing it must carry—it must absorb in some proportion, depending entirely on the circumstances, all the elements of cost, which would include the items which you mention.

Q. Now, under the same assumed circumstances, would you say that any such charges which would continue even though the production of product B were discontinued, although in some lesser but unascertainable amount, should not be included in the cost of production of product B? A. No.

Q. In other words, is it your opinion that the fact that some charge which otherwise would be a

(Testimony of Francis P. Farquhar.)

proper charge to include in cost of production is not objectionable merely because it [1085] might continue in some lesser or unascertainable amount even though you discontinued the production of the particular product?

A. Well, if you discontinued the production of this particular product, you have to re-allocate these overhead charges; but that doesn't mean that you wouldn't include them as long as the product is being produced.

Q. In your opinion, Mr. Farquhar, and assuming without conceding, that product B is a by-product in the sense that I have mentioned, in your opinion, should any different accounting methods or principles be applied in determining the cost of production of that product than you would apply ordinarily in determining the cost of production of any one of a number of products produced in a single plant?

A. I think the theory is the same. The practical method of determining how much would vary with the circumstances, but the theory would hold in all cases.

Q. Now, under the same assumed circumstances, assume that you have a shipping compartment in this plant in which both products C and B are shipped, and that the direct labor employed in the shipment of each of these two products is determined by time card records, and is charged

(Testimony of Francis P. Farquhar.)

to each of the two products in accordance with the time card records, but that expense such as the expenses of a foreman, a foreman's assistant, a shipping clerk, demurrage and tractor expense [1086] in connection with the shipment of the two products in allocated and charged to the two products in the respective proportions that the tonnage of each product shipped bears to the total tonnage handled. Now, in your opinion, would that be good and proper accounting practice?

A. If I understand you correctly, you are talking now about charges, shipping charges that relate only to B and C; that do not relate to the main product; is that right?

Q. Well, let me inject A into the picture as well.

A. Well, it doesn't make any difference how many different products are there. There are besides the direct labor, which can be ascertained from time cards, or through a foreman's allocation on the spot at the time—it amounts to the same thing—besides those, there are certain elements of shipping expense—you mentioned, I think, the foreman, himself, or general superintendence of shipping—that have to be absorbed in the cost of shipping all of the products; and the method of ascertaining how much to each, is one that requires a study on the spot of the circumstances.

There are various ways of doing it, one of which is what you stated, on a tonnage basis, which frequently, is a sounder method than to do it on a

(Testimony of Francis P. Farquhar.)

basis of adding up the other costs or the labor time. It could conceivably be one of the others; it could very properly be allocated on and measured by the volume or weight of materials handled.

Q. And under your hypotheses would you say that it would be improper to allocate any of these expenses, shipping expenses, to product B merely by virtue of the fact that you designate Product B as being a by-product?

A. Well, the designation "by-product" seems to be more or less of an agreed term. It is what it really is that counts. If this product has reached any considerable volume, and especially if separate and distinct operations are applied to it, it becomes, whether you call it a by-product or not, something definite of itself, and there it is; and if labor or expense is applied in transforming it or moving it, that is part of the cost of it.

Q. Will you tell us this: Whether or not in accordance with good and accepted accounting practice, it is customary to include plant overhead in cost of production of a manufactured product?

A. Well, you can find all stages of accounting practice in cost accounting. There has been a great deal of progress and development in it in recent years, and I think the tendency is to more and more specifically allocate all kinds of costs, either through a machine hour rate, or through a process rate which will gather together in one factor all of these various expenses. Therefore, I will say that it is—anything that tends to absorb in their actual

(Testimony of Francis P. Farquhar.)

incidence all elements of cost is good accounting practice. [1088]

Q. On what do you base these opinions, Mr. Farquhar?

A. Well, I base them on actual work, in devising cost methods and in familiarity with the practice in our office and in the office of our associates.

We get their reports frequently, particularly if there is any new development or modern up-to-date job on installation accounting, our office is furnished with a report. I read and digest those, discuss them with my partner. I have in front of me constantly, right in front of my desk, the entire file of the bulletins of the National Association of Cost Accountants, and have watched with a great deal of interest the improvement in cost procedure that is shown through those bulletins. Those are bulletins that come out twice a month, and have since 1920.

There are many books on the subject. One of the earlier ones that I was familiar with when I was in the East with Scovell, Wellington was the *Burden Methods*, by A. Hamilton Church, whom I have always regarded as one of the leaders in sound cost accounting methods, and I have followed and read his subsequent publications.

To go back quite a way, in the time I was in the Navy, I dealt specifically with the decisions on cost matters. I don't recall that the problem that we are discussing here was any specific problem at that time, but I had general familiarity with indus-

(Testimony of Francis P. Farquhar.)

trial accounting and acted as what you might [1089] call the court of first instance in deciding what went into costs. Later I prepared a Manual of Cost Accounting for the Navy Department, which dealt with costs.

I have always taken a great interest in the theory of cost accounting, and I think it is through this continued interest and with the accumulation of practice over thirty years that I visualize cost accounting as something that absorbs the costs; and the problem is each time a different one in a factory, but the theories and principles are constant.

Mr. Rosenberg: No further questions.

Cross Examination

Mr. Bennett: Q. Mr. Farquhar, have you ever had experience in your lifetime of setting up or observing a system of cost accounting applicable to a by-product where there was contract between the buyer and the seller, where the buyer's price was determined or affected by any actual increase in costs between two comparative periods?

A. I can't recall any case precisely of that character, but I can say that I have had a part in setting up a method of cost accounting where the price was based upon the cost, and we had to departmentalize the costs, because there were different products; but in that case the entire output was subject to a somewhat similar contractual—

Q. There was no question there, then, of what costs should be allocated and what a cost should be as to any specific [1090] product of that plant?

(Testimony of Francis P. Farquhar.)

A. Well, we had to allocate them in order to get the respective costs of the different products.

Q. But of the whole total of the thing, it didn't make any particular difference so far as the purchaser was concerned as to how those costs were allocated, did it?

A. Well, I would have to develop that considerable to answer that question off-hand. I have in mind the allocation of costs of the construction of a plant where the construction of the plant, itself, was a cost-plus job, and it was of considerable importance to determine the cost of construction of each separate department of that plant, because the costs of the various products would vary considerably with the burden rate on each department. That was a mining company, mining chemicals. So I think, while I was not engaged directly in the determination of the cost of the product, itself, indirectly I was in allocating the overhead of the contractor's office to the departments. I think it is an analogous case.

Q. That was an ordinary cost-plus profit construction case?

A. That is right, but the point was not the cost—the payment to the contractor, but the setting up of accounts so that the manufacturer could use them afterwards.

Q. So that he could for the different parts of his plant determine the amount of the cost that that particular plant should bear in its total cost of construction, is that correct? [1091]

(Testimony of Francis P. Farquhar.)

A. Yes; it was important to know the difference between a liquid or a powdered material.

Q. Do I understand you to say that you do not draw any distinction at all in cost accounting, in the determination of the cost of manufacture of the by-product than you would in the case of a co-product or primary product?

A. In theory, no. In practice, frequently.

Q. As a matter of fact, in most instances of typical by-product manufacture, the manufacturer simply credits against the cost of the production of the main product the sales received from the by-product, isn't that correct?

A. It may be in some instances. I wouldn't say that that is sound theory.

Q. Well, isn't it the more general practice in handling the matter of cost accounting for by-products?

A. Only where the cost of—the expense of separating those costs is out of proportion to the results. If the by-product, as it is called, is of any considerable magnitude, I think you wouldn't get sound costs if you didn't set up separate accounting.

Q. Well, you are speaking of theory on the one hand, and I was speaking of the usual practice on the other. I will ask you if it isn't a fact that in determining the cost of a manufactured by-product that they only start figuring the cost at [1092] the point of separation from the material going into the main product?

(Testimony of Francis P. Farquhar.)

A. That is frequently the case, but not always. Sometimes it is possible to determine costs further back.

Q. That would be, according to what experience you have had, the more usual or customary method followed in by-product cost accounting, would it not?

A. Well, in the sense that perhaps the best application of theory is rarely found, and that frequently the other method is satisfactory for the purposes of manufacture. I think where it is only for the purposes of the manufacturer I could think of more instances where they did not refine the costs than where they do.

Q. Now, in the case of determining the cost of a co-product or a joint product, they start the matter of costs including processing costs back at the beginning of the operation, do they not?

A. Where it is possible.

Q. Now, where a manufacturer starts the charging of costs or the allocating of costs only after the point of separation, that would indicate, would it not, that that manufacturer is treating that product as a by-product?

Mr. Rosenberg: Just a moment. I will object to that on the ground that it is incompetent, irrelevant, and immaterial, and argumentative. [1093]

Mr. Bennett: This is cross-examination. I think it is highly material, your Honor.

The Court: Read the question, Mr. Reporter.

(The reporter read the question.)

(Testimony of Francis P. Farquhar.)

The Court: You may answer.

A. Well, I don't think that that is the test of a by-product. There might be considerably difficulty in some processes in determining that cost at an earlier stage, but that doesn't change the theory that if it is possible to allocate costs they should be allocated at as early a stage as they can be done where it is a practical matter to do so.

Q. Take the case of these three products that counsel for the defendant mentions, products A, B, and C, all of which result from or are made from a base material which we will call, say, seawater, or a condensed form of seawater, as the initial raw product. Now, if you are setting up a system of cost accounting and treat those products as joint or co-products, they would start bearing the share of the cost of the operations at that plant from the beginning, would they not, Mr. Farquhar?

A. If it is practical to ascertain them. [1094]

Q. Now, if, on the other hand, one of those products, let us say product B, was a byproduct which came off in the course of the process of manufacturing, say, the end products C, and that required some further processing, and if B was in fact, a byproduct, then in the usual case as the practice is employed in industrial firms, the charges would start—the costs would start at the point of separation in the case of a by-product, would it not?

A. Well, I am afraid I fail to get the distinction between a by-product and a co-product where this

(Testimony of Francis P. Farquhar.)

by-product has so much done to it after the point of separation; the distinction between a by-product and co-product seems to me not quite clear. A by-product as described here—the so-called by-product—appears to have a further process by which another product comes out of it, and that seems to me to be getting pretty far away from the customary definition of a by-product, which—

Q. Well, in this case, then, which you are speaking of, you say the situation involved here, you would go back and pick up and charge against the so-called by-product at the very start of the manufacturing process, would you not?

A. If it is possible. I don't know enough about the physical layout or the character of this particular substance to know whether there is a means of measuring earlier, that is—

Q. Take the case of a peach canner who buys peaches and his primary product is the canning of peaches. As part of that [1095] operation he has to remove the pits in order to cut and slice and can the peaches. Those pits, assume them to be wholly valueless, valueless waste, unless they were ground up and formed into a briquet; that further processing involved the grinding of the peach pits into an outer or granular form and the pressing of these bits into the briquets. Now, would you consider that a by-product or a co-product?

A. Well, there is very little distinction.

Q. Well, you mean that you wouldn't designate it either a by-product or a co-product; you would

(Testimony of Francis P. Farquhar.)

treat it just the same as you would a co-product for accounting purposes?

A. It all depends on the volume and the proportion. The only distinction between a by-product and a co-product is one of proportion.

Q. Well, let us consider that—

The Court: Pardon me. What do you mean by “proportion”?

A. Well, if the so-called—if the product is of very minor consequence, that seems to me to justify the use of the term by-product. But if it involves any considerable amount of handling or reprocessing, I would call it a co-product.

Mr. Bennett: Q. Well, I have outlined the process that is involved in the case of the peach pits and let us assume further that the—

A. I think that the peach pit would ordinarily be called a by-product. [1096]

Q. Let us assume the peach pit weighs approximately the same as the peach, itself, and that the finished briquet of the peach pits sells for approximately one-ninth or one-tenth that the peaches do in the cans after they are canned. Would you still consider that as a by-product?

A. Yes, I think it ordinarily would be called a by-product.

Q. A by-product? A. Yes.

Q. When would you pick up the cost of processing of the by-product? Would you pick it up at and after the time the peach pit was removed from the peach, or would you pick it up beginning when

(Testimony of Francis P. Farquhar.)

the peaches were delivered to the cannery by the farmer?

A. Well, if I were installing an accounting system, I think my first inquiry would be if there is any value to the peach pit before it is processed.

Q. I told you, Mr. Farquhar, it had no value; it would be a valueless waste unless it was further processed by grinding it and pressing it, and forming it into a briquet. On that supposition, and with the further matters, the relative weight and value that I have gotten you, would you still consider that a by-product?

A. Well, I think that I should complete my statement there, which is really an answer to your question, that if an adjoining manufacturer were willing to buy those pits even for a very inconsiderable or minute sum in order to re-process them, then [1097] that would give an opportunity for measuring the material cost of the by-product; but if, as you say, they were—nobody would offer for it, then there is no assignable value to the material, itself.

Q. And you would start your cost accounting at the point of separation of the peach pits from the pits? [1097-a]

A. If it is true that there is no means of determining a relative portion of the value of the material, then I would start the cost accounting for the by-product in the processing of the peach pit.

Q. In that sort of a situation would you assign to the cost of the by-product the plant overhead, a share of the entire overhead of the plant?

(Testimony of Francis P. Farquhar.)

A. In so far as it can be allocated to a separate process, if separate process goes on, it immediately picks up some portion of the plant overhead.

Q. I am stating a situation where there are only two products produced at this cannery: one is canned peaches and one is the briquettes, and assuming also in the manufacturing of these briquettes from the peach pits, the labor involved in the drying and grinding and forming them into the briquettes would take foremen and the canning operation in canning peaches, direct labor would involve 32 men: would you also consider in adding to the cost of manufacturing the briquettes, in addition the direct cost of the labor and such materials as went into that, depreciation on the machines and part of the plant that were used for making briquettes, taxes and insurance, also a portion of the entire plant overhead on the basis, say, that the direct labor involved in the manufacture of the by-product briquettes or to the direct labor involved in canning peaches?

A. I don't think direct labor is necessarily the sound measure [1098] of allocating overhead.

Q. Why not?

A. Because there are many cases where the direct labor would not be the entire measure at all.

Q. In other words, there might be a wholly disproportionate quantum of labor either in the manufacture of the by-product or the manufacture of the primary product?

(Testimony of Francis P. Farquhar.)

A. The by-product might actually absorb a greater proportion of the overhead due to other circumstances than if you measured it by direct labor cost.

Q. So you would say as an abstract proposition in allocating these overhead costs in the case of by-products that the direct labor basis would not be a suitable method of allocating?

A. No, I didn't say that. I said it might be or it might not be, depending on the circumstances. I am inclined to use a process factory in which you assemble the various costs into a factor process rather than proportion it by direct labor cost.

Mr. Rosenberg: Just a minute. You asked a question that you did not permit the witness to answer under your hypothetical set of circumstances as to whether he would charge that—

The Witness: Yes, I would charge that—

Mr. Bennett: The witness answered that question, counsel, and I asked the final question as to whether he would allocate it on this labor basis and he said he would not.

The Witness: No, I said in some cases I would and in [1099] some cases I would not.

Q. The hypothetical case I gave you was that in which the by-product processing from point of separation required foremen. The other direct labor involved in the manufacture of primary product, canned peaches, involved 32 men, and I gave you the relative weights of these products and their relative values. Now, I ask you whether you con-

(Testimony of Francis P. Farquhar.)

sider it a sound basis of cost accounting to allocate to the plant overhead the indirect items on that ratio of labor to labor, direct labor to labor.

A. That would be a sound basis, but it might be that because of the greater amount of costly machinery involved in one process or the other, that that would greatly outweigh the labor factor in determining the allocation.

Q. Such a method of allocation, without going into the refinements which you have made, might well produce a determination of cost which would reflect the actual costs, wouldn't it?

A. It could, yes, and if you did it strictly on a number of laborers, that might or might not reflect true cost. There are other ways I would consider more reliable.

Q. When we deal with the direct cost in an operation of that kind, we can determine without any trouble under, perhaps, several methods of accounting the actual direct costs that go into that product, can't we? A. Yes.

Q. In, for example, this hypothetical case, the briquettes [1100] made from peach pits, by determining the salary or wages or labor that is actually employed in the further processing of those peach pits, the light and power, the fuel and such materials that go into that particular product, we can determine with exactitude precisely the amount of the direct cost involved.

A. With reasonable accuracy, yes.

Q. When we get into this matter of allocating

(Testimony of Francis P. Farquhar.)

the costs on this situation I mentioned on the labor basis, we get at best an estimate of cost, don't we?

A. Yes, all allocations of indirect cost are at best an estimate.

Q. At best an estimate? A. That's right.

Q. And they do not necessarily reflect or reveal as contra-distinguished from the situation of direct cost the actual costs involved?

A. With this qualification, that all of the indirect costs have to be absorbed some way.

Q. Yes. Well, so far as the manufacturer himself is concerned, if he alone is concerned with the matter of cost accounting of a plant where, perhaps, three products are being produced or forty products are being produced, and as you say, we strive to allocate against every one of those products some part of the overhead and indirect charges, the plant overhead [1101] burden and it involves, as you say, an estimate in each case. A. An estimate is not a guess.

Q. Well, it is something different from an exact determination, isn't it?

A. I don't think any cost accounting can be considered exact, but it can be fairly reliable.

Q. Of course, you concede, do you not, that in determining direct costs you can determine those with greater exactness than you can the allocation of indirect? A. Yes.

Q. The minute you get into allocating costs you inject the element of estimate and to a certain extent, conjecture, do you not?

(Testimony of Francis P. Farquhar.)

A. You can greatly refine that, and the more you analyze the nearer you come to a sound and reliable basis.

Q. Well, now, going back for just a moment, Mr. Farquhar, to this hypothetical situation in the manufacture of peach pits, I asked you whether you considered that the allocation of the overhead to this by-product on the basis of direct labor charges was proper and you said, "I could not say that without further determining whether that was a proper relation." A. That's right.

Q. So you would not have this Court understand that in any number of given situations that it is equally appropriate to make allocations of overhead on a direct labor basis, would you? [1102]

A. If I understand you correctly, it is not the sole method nor always the best. In some instances it might be right and in some instances it might not be very far from a sound basis.

Q. In some instances it might involve as to the whole matter of the overhead a reasonably approximate estimate of the allocations, and in another case it might involve an estimate that was far from the facts of exactness, isn't that so?

A. Yes.

Q. In other words, you consider that you have to determine these relative factors something beyond the mere relation of the direct labor involved in the by-product and the indirect labor involved in the main product?

A. In modern cost accounting direct labor is rarely used as the basis of allocation where there

(Testimony of Francis P. Farquhar.)

is a considerable amount of physical plant involved. May I illustrate that? I don't know that it is pertinent——

The Court: You may.

Mr. Bennett: Go ahead.

The Witness: In two adjoining processes, one, we will say, in casting, a considerable amount of the cost is labor and supervision of labor; while in an adjoining machine shop with an automatic machine there may be very few men. Now, to say, because in the machine shop there were only a few men while in the foundry there were many men, that you should allocate by the number of laborers or the payroll, obviously it would [1103] not be a sound method of allocation. Every individual case of processing has to be studied. I have actually been on my hands and knees through factories determining a square foot factor, which is one way of doing it.

Q. And in the case you mentioned, to apply this direct labor basis of allocation in the hypothetical situation, isn't it true that you have loaded on one product, either the primary product or the by-product a share of overhead which is wholly disproportionate to the actual cost to the manufacturer of that product?

A. In the extreme case I cite, if you did it by labor, it would disproportionate it.

Q. Yes. Now, Mr. Farquhar, in these items that you would allocate, how far would you go? You would limit them to the actual allocation of plant overhead, would you not?

(Testimony of Francis P. Farquhar.)

A. Everything that relates to the production of the product.

Q. Things that don't relate to the production of the product would not be allocated to it?

A. Not to the production cost, but there are other costs that follow on distribution.

Q. Yes, you have legal costs, you have general administrative cost, but you would not allocate them as costs of production on a product, would you?

A. Yes, in many factories the general administration deals almost entirely with production and when selling itself is [1104] automatic.

Q. What is that?

A. The product sells itself automatically and most of the administration deals with production.

Q. How far up do you go? Do you allocate all the way up to, say, an office that may be in Paris or London, England, the overhead of home office administration in determining the actual cost to manufacture?

A. It could be if that Paris office were engaged in the purchase of materials for dressmaking.

Q. That would be for the reason that it had a direct relation to the manufacturing of that product?

A. Yes.

Q. But generally, in determining the cost of actual manufacture, they differentiate between what we call purely administrative costs and manufacturing costs, don't they?

A. I think there are a great many instances

(Testimony of Francis P. Farquhar.)

where you could not make that flat statement. The test is in cost accounting to absorb as much cost as possible into the various steps of the production and distribution of the article.

Q. That would include sales costs and everything else?

A. The selling expense can be apportioned between different types of articles, but a selling expense is not a cost of production.

Q. We are talking about cost of production.

A. Well, cost of production may have a considerable share of the administrative expense where selling is very little. Going back to my Navy experience, there was no selling expense after the contracts, and all the administrative expense was apportioned as overhead and acknowledged as overhead and paid for by the United States Government, the Navy Department, as part of the cost of building destroyers. There was just a minute amount left for selling.

Q. Suppose in a plant they have a certain amount of overhead that has to do with something wholly dissociated from the manufacture of a particular product that you assign as a part of the cost of the product or allocate a part of the cost of that product or portion of that particular item for overhead——

A. If it is dissociated, no.

Q. Supposing this peach cannery that I mentioned to you a while ago has suddenly decided it wanted to do some research in canning string beans

(Testimony of Francis P. Farquhar.)

and set up a research department, scientists, and desks and other things; would you allocate a portion of that to the cost of manufacturing a by-product, briquettes and peach pits.

Mr. Rosenberg: Just a moment. I object to that on the ground there is no conceivable foundation for that.

The Court: We are going far afield and into considerable romancing on this. I say that advisedly, counsel. With that in mind, proceed. [1106]

Mr. Bennett: If Your Honor feels that way, obviously I will not go any further.

That is all, Mr. Farquhar.

Mr. Rosenberg: That's all.

The Court: We will adjourn until tomorrow morning at 10:00 o'clock.

(Whereupon an adjournment was taken until 10:00 o'clock tomorrow morning, Wednesday, December 31, 1947.)

CERTIFICATE OF REPORTER

We, Official Reporters and Official Reporters pro tem Certify that the foregoing transcript of Record pages is a true and correct transcript of the matter therein contained as reported by us and thereafter reduced to typewriting, to the best of our ability.

/s/ JOSEPH J. SWEENEY. [1106-a]

Wednesday, December 31, 1947, 10:00 o'clock a.m.

The Clerk: Pacific Portland Cement Company v. Westvaco.

GEORGE A. MAXWELL

called as a witness on behalf of the defendant, being first duly sworn, testified as follows:

Q. (The Clerk): Will you state your name?

A. George A. Maxwell.

Direct Examination

Q. (Mr. Rosenberg): Mr. Maxwell, what is your business or profession?

A. Certified public accountant in practice.

Q. Since when have you been a certified public accountant?

A. Since about 1921.

Q. Are you affiliated with any firm?

A. I am a resident manager of Barrow-Wade-Guthrie & Company, a national firm.

Q. That is a national firm of certified public accountants?

A. Yes.

Q. Where do they have offices, Mr. Maxwell?

A. The principal office is in New York City, and other offices are throughout the country: Chicago, Boston, Philadelphia, Los Angeles, San Francisco, Seattle and Canada; correspondents abroad.

Q. Will you give us an outline of your experience in accounting since you have been a certified public accountant?

A. Since I have been a certified public accountant, and before that, I practiced professionally with the emphasis on industrial accounting, cost systems, their installations, the determination of costs for various purposes—for example, in the settlement of cost-plus contracts with the government

(Testimony of George A. Maxwell.)

and generally, accounting practice with the emphasis on industrial accounting.

Q. Are you a member of any accounting societies or institutes?

A. Yes, I am; a CPA of California and also of Maryland and the State of New Hampshire. I am a member of the American Institute of Accountants. I am a member of the National Association of Cost Accountants. I am a member of the Society of Industrial Engineers and was a member of the Controllers Institute of America.

Q. In your experience the emphasis has been on industrial and cost accounting, is that correct?

A. Yes.

Q. Mr. Maxwell, I will ask you to assume a chemical plant in which from a common raw material three different products are recovered——

A. Yes.

Q. ——which I will refer to as products A, B and C, and I will ask you to assume that product B is technically a by-product in [1108] the sense that it consists in part of a chemical element which must be extracted from the raw material in order to produce product C in a pure and salable form. Assume that in order to convert product B into a salable chemical product after it is separated from the raw material, it is necessary to process it, and for the purpose of such processing it is necessary to have a physical plant devoted exclusively to such processing, and it is likewise necessary to employ labor which devotes itself exclusively to the process-

(Testimony of George A. Maxwell.)

ing of this material or this product in order to convert it into a merchantable and marketable product; and assume further that by reason of a contract it is necessary that the producer of this product B determine the cost of production or cost of manufacture of that product: Under those circumstances will you state whether or not in your opinion it is proper and good accounting practice to include in the cost of production of product B a portion of the overhead and expense of the plant?

A. Oh, yes, certainly; and that is the consensus of opinion of authorities.

Mr. Bennett: Now, I move to strike out, if Your Honor please, the volunteer statement of the witness that that is the consensus of opinion of the authorities.

Mr. Rosenberg: I submit that is responsive.

Mrs. Bennett: It is egotism in the extreme and it is not proper testimony. [1109]

The Court: I consider it proper testimony. You may examine him on his knowledge of the authorities. Let the question and answer stand.

Q. (Mr. Rosenberg): Mr. Maxwell, under the same assumed circumstances, would it be proper and in accordance with good accounting practice to include in the cost of production of this product B a portion of the indirect charges of the plant, such as general superintendence and other charges for labor which are devoted to the production of the several products, including product B, but as to which it is impossible or impractical to keep

(Testimony of George A. Maxwell.)

records of the accurate time devoted exclusively to each particular product?

A. Yes, definitely. When you refer to overhead expenses, the reason they are overhead is because they can not be definitely allocated to a product at the inception of the expenditure, and therefore they must be scientifically distributed over all products that share in whatever service for which the expense is incurred.

Q. Is there any reason in your opinion and based upon your experience, why such charges should not be included in determining the cost of production of this product B, which I have described?

A. They should be included. Its prorata should be included in the cost of product B.

Q. Under the same assumed circumstances, will you tell me in [1110] your opinion as an expert whether any such charges which would continue even though the production of product B were discontinued, although in some lesser but unascertainable amount, should be excluded in the cost of production B merely by virtue of the fact that they can not be determined with exactitude?

A. The discontinuance of a product does not alter the fact that while the product is being produced, it should take its prorata share of overhead. The same situation arises with respect to what you might call a primary product. If a primary product is discontinued, it would necessarily follow that the overhead expenses, some of them,

(Testimony of George A. Maxwell.)

would continue, such as general management, insurance, taxes, depreciation, plant maintenance, and so forth, which would necessarily have to be distributed over the remaining products which were being continued in production, so that the effect of a discontinuance of a primary product or a by-product or so-called by-product would probably load a larger charge on the remaining products, once there was an increase in the production of those products. But the fact of a discontinuance of a product has no bearing on the necessity to prorate the manufacturing overhead expenses.

Q. Under the same assumed circumstances, will you assume that in this plant there is a shipping department maintained from which these products A, B and C are shipped, and that the direct labor employed in the shipment of the respective products, [1111] as determined by time card records, is charged to each of the products, and that other expense, such as foremen, foremen's assistant, shipping clerk, demurrage, tractor expense in connection with the shipment of the several products is allocated and charged to the three products in the respective proportions that the tonnage of each product shipped bears to the total tonnage handled: in those circumstances, in your opinion, would that be a good and proper accounting practice?

A. Yes, in a general way that would be proper accounting. All products that are shipped and which utilize the services of the shipping department, should bear its prorata of the cost of operat-

(Testimony of George A. Maxwell.)

ing that department. Otherwise that department would be rendering a gratuitous service. However, there is a factual aspect in it and that is the cost of shipping, whether it is a waste product, a co-product, a by-product or a primary product. All should bear this proportion of the cost of that service. Any other conclusion would be illogical.

Q. Mr. Maxwell, will you state whether or not in the case of a so-called by-product such as I have described, where it requires processing, physical plant and labor to be directly employed in making it a marketable product, whether, in your opinion, any different accounting method should be employed in determining the cost of such a product than would be employed generally in determining the cost of a primary product or the cost of a number of co-products produced in a single plant. [1112]

A. In my opinion, there is really no room in the nomenclature of industrial accounting for the word by-products. If a plant in conversational language, for example produces 40 products and 5 which are ordinarily referred to as by-products, to the accountant it does not produce 40 products and 5 by-products, but it produces 45 products, and the total expenditures of the concern, of the plant, of the organization should be absorbed by all 45 products, and the object of cost accounting is to find the most realistic basis upon which to prorate those costs in the aggregate, and those costs, some of them are direct and can be specifically and with precision allocated to each product. That is generally referred

(Testimony of George A. Maxwell.)

to as the direct labor cost or the direct material cost. Then there are other costs, a long list of costs, which can not be so allocated. It would be a physical impossibility to do so.

I might illustrate that by taking the salary of the general superintendent of the plant. During the course of a day he probably visits every department in the plant or maybe some departments he does not visit in the course of a week and it would be a physical impossibility for that superintendent, for example, to docket the places he visits from day to day, from week to week and from month to month, and that would be essential if you were going to have a mathematically accurate allocation of his salary to cost of products.

However, since that is impracticable, and as a matter of fact it was never attempted, then some realistic scientific basis which is pure estimate must be found, whereby you distribute that superintendent's salary; and particularly, if there were five or six thousand products, it should be obvious how impossible it would be; and the same applies to insurance, maintenance, repair work, taxes, and the whole gamut of expenses comprehended in the management of the plant.

Q. Will you tell us, Mr. Maxwell, on what you base the opinion you have just expressed?

A. I base these opinions on over thirty years' experience in professional accounting, and also from my studies I have had to read most of the literature on the subject in order to take my examinations.

(Testimony of George A. Maxwell.)

Q. Can you refer us to any comparable situations that you have run across in the course of your experience? A. Oh, yes, many.

Q. In which so-called by-product accounting has been handled in the manner you have mentioned?

A. Oh, yes, many. You find in very, very small industries where there is no attempt to have scientific accounting, that they use loose methods. Then, as you go up the scale, until you arrive at large industries, where management must have mathematically accurate data with which to manage the plant and guide its affairs, their accounts are maintained by [1114] thoroughly trained industrial engineers and accountants, and of course in that bracket you find all the recognized principles of good accounting are observed.

Q. What type of industry, for instance, have you had experience with where products comparable to the one that I have mentioned have been fully accounted for in the cost accounting, including overhead expense and indirect charges?

A. I could mention the chemical industry, automobile industry, airplane industry, textile industry, machine shops, and quite a general cross section of industry. I have had practical experience in all of them, and I have made cost installations in many of them.

Q. Are these opinions you have expressed some new opinions that you have developed for the purpose of this case, or are they opinions that you have held for some period of time?

(Testimony of George A. Maxwell.)

A. For many years. Of course, there is some development in cost accounting, but there has been no change in the definition of what constitutes cost. There have been changes in the methods of applying the definition in specific cases. For example, I think that it is quite unanimous among all accountants that cost of production, as it is defined in the regulations of the Treasury Department for the Federal Government Income Tax Law says, and it makes no distinction between by-products and the primary products.

Mr. Bennett: Now, just a moment, your Honor, this is not [1115] the best evidence. If we are going to have what the Federal Treasury Regulations are or what they provide, let us have them and not have this witness' testimony on that.

The Court: Just keep in mind that this witness comes on as an expert witness.

Mr. Bennett: But he is doing what the law does not permit. The law does not permit a witness on direct examination to quote some book or to quote some document. Now, the best evidence rule is, and I can cite your Honor authorities——

Mr. Rosenberg: May I shorten up this, if the Court please? There is no question on that point. There is a Civil Code section that provides when an expert witness is on direct examination he is not only permitted to express his opinions, but he is permitted to state the reasons for the opinions that he expresses. That is the Code of Civil Procedure, Section 1872, which says, "Whenever an

(Testimony of George A. Maxwell.)

expert witness gives his opinion he may, upon direct examination, be asked to state the reasons for such opinions, and may be fully cross-examined thereon by opposing counsel.

The Court: That is my understanding.

Mr. Bennett: Yes, your Honor, that means he can state his reason, but he cannot say that a certain book says, or what some other authority or alleged authority believes. Let me call your Honor's attention to what McBane says:

"On direct examination an expert witness may not [1116] incorporate into his testimony extracts from the writings of standard authorities in the field in which he is giving opinion evidence."

The reason for the rule is obvious.

The Court: Just a moment. Isn't the witness giving his reasons?

Mr. Bennett: But he cannot give the rules of the Treasury Department.

The Court: Read that again.

Mr. Bennett: It says:

"On direct examination an expert witness may not incorporate into his testimony extracts from the writings of standard authorities in the field in which he is giving opinion evidence."

The Court: There is an absence of that here. Proceed.

Mr. Rosenberg: He is merely stating what the law is.

(Testimony of George A. Maxwell.)

Mr. Bennett: I move to strike that portion of the witness' testimony which has to do with what the Federal Regulations provide.

The Court: In the interest of time I will omit that.

Mr. Bennett: Does your Honor strike that portion of the answer?

The Court: It may go out.

Q. (Mr. Rosenberg): Just let me ask you this one further question: You are prepared, are you, Mr. Maxwell, to provide [1117] authorities for the opinions that would sustain the opinions that you have expressed? A. Oh, yes.

Q. What do those authorities consist of?

A. Those authorities would consist of writers of standard texts who are in practice as industrial engineers and accountants, and most of whom are professors in the universities of the country.

For example, Eric Camman published a book entitled, "Basic Standard Costs." Eric Camman is a senior partner in the firm of Peat, Marwick, Mitchell & Company.

Mr. Bennett: I am sorry to interrupt, but my objection goes to this line of testimony. I object to the question and move to strike the answer on the same grounds that I stated in my previous objection.

The Court: Let the question and answer stand. Proceed, reframe your question.

Mr. Rosenberg: He was in the process of answering the question, your Honor.

(Testimony of George A. Maxwell.)

The Court: All right, what other authorities?

A. (The Witness): Another authority is Specthrie, a professor at Northwestern University and an industrial engineer wrote "Industrial Accounting." Another authority is Samuel Sanders, who is a professor of industrial accounting at Harvard. His book is also called "Industrial Accounting." Then [1118] there is Lawrence, whose book is called "Cost Accounting." Then there is a work by Newlove and Pratt, called, "Specialized Accounting." Both Newlove and Pratt are industrial engineers, and recognized as authorities in cost accounting. Then, of course, there is the Handbook of Cost Accounting Methods. It is a compendium of the writings of many authorities, consisting of approximately 2000 pages. That is regarded as a very authoritative work for industrial engineers and accountants.

Q. (By Mr. Rosenberg): Let me ask you this, Mr. Maxwell: I asked you whether these opinions that you have expressed are opinions that you have held for some period of time. Have you written anything on this subject that would corroborate the opinions that you have expressed from the witness stand today?

A. Yes, several years ago I wrote a little treatise on "Cost Control For Wineries," which was published by Prentiss-Hall.

Q. In that work did you also express the view that in accounting having so-called by-products, all elements for cost accounting, including overhead, should be included?

(Testimony of George A. Maxwell.)

A. Oh, yes, definitely.

Mr. Rosenberg: That's all.

Cross-Examination

Q. (Mr. Bennett): As I understand it, you treat by-products in determining the cost of manufacture identically as you would [1119] the main or primary products, would you?

A. Yes, and particularly if there was additional processing after the split-off point. In fact, authorities do not speak of it as a by-product. They speak of it as a co-product.

Mr. Bennett: I move to strike that part of the witness' answer that the authorities do not speak of it as a by-product, but speak of it as a co-product. as not being responsive to my question, and a volunteer and prejudicial statement.

The Court: The question and answer may stand. Objection is overruled. Proceed.

Q. (Mr. Bennett): Well, you would treat, then, a by-product that requires any further processing to make it salable, when it comes off the material that is used for the main or primary product as a valueless waste, you would treat that so far as accounting purposes are concerned as you would any co-product? A. Precisely.

Q. You make no difference at all?

A. None, whatsoever, in the method of accounting.

Q. In the case of the lumber mill that necessarily has to produce some sawdust as a result of its sawing operations, and that sawdust at the time

(Testimony of George A. Maxwell.)

and place is valueless unless something is done to it, the sawmill needs additional machinery or equipment to mold that sawdust into little briquets and sells the briquets; you would consider the briquets, so far as cost accounting is concerned, just as you would the boards of lumber [1120] that come out of the mill? A. Precisely.

Q. And you would allocate to those briquets a portion of the complete overhead, that is, the cost of the logs in the woods?

Mr. Rosenberg: Just a minute, we were talking about overhead. Now you are talking about cost of material.

Mr. Bennett: Well, all right, but I think I am entitled to ask that question.

The Court: Stay out of the woods for the moment.

Mr. Bennett: All right, I will get out of the woods and into the plant. However, with your Honor's dispensation, I am coming back to the woods literally for just a moment.

Q. All of the overhead of that plant, the superintendence, the accounting, the various and sundry and so-called indirect items, you would allocate a portion of them to the actual cost of manufacture of these briquets, would you?

A. Yes, that portion which would be, as far as could be estimated, actually incurred with respect to briquets its fair, scientific share.

Q. In the manufacture of the briquets, we know they have four people operating the machinery for

(Testimony of George A. Maxwell.)

the gathering of the sawdust, forming the sawdust into briquets, and moving them onto the railroad trains, and shipping them away. That is the only direct labor. And the only direct charge is a certain amount of power and fuel that is used in the manufacture of the [1121] briquets and a certain amount of material that is used to bind them. There is no difficulty in definitely and exactly, as you say, determining those direct costs?

A. Not much difficulty.

Q. Well, there isn't any difficulty if the books are kept properly?

A. Well, the difficulty is this: All the transactions in a plant must be documented before you can do any accounting with them, and if they don't document them, the withdrawal of materials from the inventories and stores so they can be charged to the manufacture of the briquets, then you have to find some basis of cost.

Q. But I am assuming a plant does that. It has a payroll on which the labor of these four men are kept and the definite amount of materials is kept down to the cent cost, and they also keep appropriate records and time sheets of those direct charges and the power that is needed.

A. Yes.

Q. There is no difficulty in determining the direct cost down to the penny that it costs the manufacturer to make those briquets? A. Yes.

Assuming that the price of those briquets decreased to a point where it does not equal his

(Testimony of George A. Maxwell.)

direct cost, and the manufacturer then discontinues making briquets and burns the sawdust; [1122] the overhead items you would allocate while these briquets were being made would go on, would they not?

A. Possibly but not entirely. The overhead with respect to that department would probably be reduced.

Q. Suppose the degree of reduction would be unascertainable and that any diminution of any overhead would be indeterminable, do you think you would still allocate that overhead to the actual cost of the manufacture of the sawdust?

A. Definitely, because the sale price has nothing to do with the cost of manufacture. The sale price might only be a fraction of the cost of manufacture of the briquets.

Q. Now, in determining whether he is going to make a profit on those briquets and his other overhead would go on whether he makes them or not, he is concerned with what it would cost him to make the briquets? A. Yes.

Q. And that determines the actual cost of the manufacture of briquets? A. Yes.

Q. Assuming that briquets sell for \$10 a ton and these direct charges, the actual cost involved in the manufacture of the briquets as distinguished from the overhead that would go on anyway, is \$5 a ton. He is making a profit of \$5 a ton he otherwise would not have if he shut down the briquet department, isn't that so? [1123]

(Testimony of George A. Maxwell.)

A. No, that is not so. The direct charge, labor and material, is not the cost of manufacture. Probably the overhead is more than those two put together. It often is.

Q. But the overhead is something I have told you in this situation would go on.

A. That doesn't make any difference.

Q. Well, in the case I mentioned to you, if the man decided he did not want to bother with these briquets and wanted to shut down that manufacture, he would be losing \$5 a ton for all the briquets he could have made, wouldn't he?

Mr. Rosenberg: Now, just a moment; I object to that——

The Court: Proceed. This is an expert witness on the stand.

A. (The Witness): It is quite possible if he discontinued making the briquets he eliminates a product, and he would eliminate the direct costs of that product, which would be material and labor, and perhaps eliminate, possibly, some of what is called overhead expenses or distributable expenses, and that is the reason they are called overhead, because they cannot be directly measured in respect to each product. However, it is conceivable that a plant might quite properly decide not to continue making briquets if the demand for production in other categories of its products was so great that it could not devote sufficient time to the briquets in the efficient management of the plant, and they decided [1124] not to bother with that particular product.

(Testimony of George A. Maxwell.)

But the same attitude is often taken with products not by-products, but which are primary products. And when products are eliminated from the process of manufacture—and I am thinking now as I answer your question of a textile plant that has seven or eight thousand different products, and frequently they find that their method and cost of manufacture for these products is such that they cease to be profitable and they are continually dropping numbers or classifications of products. If they drop them they eliminate the direct cost with respect to them, but it is not possible to ascertain the extent to which they reduce their overhead expense in consequence of that. They may not reduce their overhead expense in terms of dollar amount, but they may reduce their overhead expense in regard to cost per unit, if in dropping these products they increase others that are profitable to such an extent that maybe they can spread their expenses more thinly over the production.

Q. (Mr. Bennett): We have agreed, as I take it, from the previous answer, that it is possible to determine exactly the direct cost of manufacture.

A. Yes.

Q. And you agree with me, do you not, that these items——

A. Excuse me, I should add with reasonable limitation, because that cannot be done with mathematical accuracy. [1125]

Q. Why could not the situation of the sawmill, with the direct costs of the manufacture and the

(Testimony of George A. Maxwell.)

manufacture of these briquets be determined with mathematical accuracy?

A. For this reason, that one month the workers may be a little more efficient than they would be the next month, so that you might have the same direct wages, but they would produce more in one month than they would produce in the next month. That would give you a different per-unit-cost no matter what your common denominator might be, pounds, tons, or briquets, no matter what it might be. So the direct cost in the course of a year with twelve operating periods where you would have twelve different direct cost periods, each one of them mathematically accurate alone, but none of them accurate with respect to the whole matter. They may be selling a product in June which was manufactured in January. There is no rule——

Q. Let us get away from the matter of profit in selling things in June that may have been produced in January, but if during a year this little separation operation of molding this sawdust into these briquets is kept properly, wages of these men solely and exclusively engaged in this business, the exact amount of materials that have gone in there, and the power needed and the accurate record is kept of the total amount of briquets by tons produced during that period—you do arrive for the 12 months period at an accurate determination of the direct [1126] charges or direct cost of manufacturing, don't you?

A. Yes, over a period of a year.

(Testimony of George A. Maxwell.)

Q. Yes.

A. Within reasonable limits, still not mathematically accurate.

Q. So we don't talk too much, you agree it would be accurate for the year?

A. Reasonably accurate, yes.

Q. You so testified, as I understood your direct examination, that the reason you have to allocate these indirect things is that it is not possible to arrive at any mathematical or arithmetical degree of certainty, is that correct?

A. Not with respect to the amount of the expenses, but with respect to the amount of expenses allocable to each individual product.

Q. Yes, I understood that. We say we have an overhead of 50 indirect items of \$100,000. There is no question about the total?

A. That's right.

Q. But by the very nature of things it is impossible to figure arithmetically what portion of these 50 indirect items that comprise the \$100,000 should be directly allocated to the by-product, isn't that right?

A. That's right.

Q. Therefore, some estimate is made? [1127]

A. That's right.

Q. And in the nature of things that has to be an arbitrary estimate doesn't it?

A. I will avoid the word "arbitrary" because it should be scientific. It could be arbitrary and very erroneous.

Q. Yes, but any method of allocation, whether it is based on the relation of direct labor or rela-

(Testimony of George A. Maxwell.)

tion of values is in the final analysis an arbitrary allocation, isn't it?

A. I think the word "arbitrary" connotes something that may or may not be based on reason. That is why I would avoid that word.

Q. Supposing that the manufacturer just followed a system of allocating overhead on the basis of relative sale values. A. Yes.

Q. That would in effect arbitrarily be assigning a certain amount?

A. That would be arbitrary, yes.

Q. And if he based it on some other system of direct labor cost, that, again, would be arbitrary, wouldn't it?

A. Yes, but not so arbitrary as on the basis of the sales value, because that would be erroneous.

Q. It would be a method that would not necessarily have an exact basis relation, is it?

A. That would also depend on the particular plant. You cannot use the same method of distribution on every plant. In one plant machinery may predominate, and in the other labor may predominate. [1128]

Q. In any event, the allocation of these charges, by the very nature of having to allocate them, produces the element of estimate or conjecture?

A. Yes.

Q. You can't do it with actual determination, can you?

A. You can't do it with actuarial mathematical accuracy

(Testimony of George A. Maxwell.)

The Court: We will take a recess.

(Recess.)

Q. (Mr. Bennett): I think, Mr. Maxwell, you referred to *The Cost Accountant's Handbook*, Ronald Press, as being the summation or the epitome of all the other discourse and writings on this subject of cost accounting.

A. It is a compendium of many authors' writings.

Q. That handbook devotes a whole chapter to cost accounting methods for by-products, doesn't it?

A. Yes, it does.

Q. And those methods are different, with the exception of one, from the methods prescribed or at least discussed for accounting for co-products or joint products? A. Yes.

Q. So this handbook itself does treat cost accounting for determining cost of by-products differently than is treated the determination of costs for co-products, isn't that a fact?

A. It makes a distinction, but I think if you will read it you will find it draws a very nebulous line between both, and also [1129] that it allocates the same cost accounting principles for both by-products and co-products.

Q. In co-products accounting it suggests that the co-products should bear the allocation of the overhead—in other words, the cost of the co-product is determined by its direct cost plus an allocated portion of the other costs? A. Yes.

Q. In other words, in the case of co-products,

(Testimony of George A. Maxwell.)

the cost is determined just as though there was one or two main products? A. Yes.

Q. In the case of by-products, the chapter suggests in the majority of instances actual determination of costs of the by-product are not made at all, but the proceeds from the by-product in various degrees are credited against the cost of manufacturing the main product?

A. No, I think you are in error there. The section—I think you will find it in Section 10—gives the various methods that the editor of the work has found in operation. He leaves the reader to probably make a selection of which method he may want to use with respect to a specific industry, but he also makes it clear that the best method is one which arrives at the realistic and factual cost of production of the by-product, which includes the direct charges plus its prorated share of the overhead.

Q. You refer now to the so-called seven methods. There are [1130] seven methods outlined in this chapter, and the seventh method is the one that provides for proration of joint costs, isn't that correct?

A. I can't recall whether that is the seventh method or whether there are eight, nine or ten. If I may look at the book——

Q. Yes, let me show it to you. I call your attention to page 502 of this book, "Cost Accountant's Handbook, Theodore Lange, Editor, Ronald Press," which is a part of the chapter "Joint and By-

(Testimony of George A. Maxwell.)

product Costs." And then we come to page 502, "Methods of Byproduct Accounting."

A. Yes.

Q. And the book states: "1. Methods of determining costs of byproducts.

"2. Methods of determining costs of joint products.

"3. Valuation of byproducts.

"4. Valuation of inventory of major products, byproducts and joint products——"

A. Yes.

Q. And then the book states, "There are several generally accepted methods of accounting for byproducts: 1. Net sales of byproducts treated as 'other income'—— A. Yes.

Q. ——"on profit and loss statement." No costs are assigned or attempted against byproducts?

A. That is right.

Q. "2. Total sales less total costs." That is another method, isn't it? A. That is right.

Q. A third method, "Total Cost less Revenue from sale of by-products." A. Yes.

Q. That is, again, no attempt is made to determine the cost of byproducts as you would a co-product, isn't that so?

A. Yes, because the cost of a by-product remains.

Q. "4. Total Cost less Value of Byproducts (including selling and administrative expense).

A. Yes.

Q. "5. Total Cost less Value of Byproducts (in-

(Testimony of George A. Maxwell.)

cluding subsequent costs and selling and administrative expense).

“6. Total Cost less Byproducts Valued at Standard cost.”

And then 7th and last. “Proration of Joint Costs.” A. Yes.

Q. Now, that is the method that you say you consider the best, the seventh?

A. Yes. Each one is better than the other. The most objectionable is the first one.

Q. Yes, and you consider the seventh as the best? A. Yes.

Q. Do you contend that this book states that that is the best [1132] method? A. Yes.

Q. Let us come to that. I refer you to page 522, where it speaks of proration of joint costs, and I quote, “Another method of byproduct accounting is to charge each product for costs subsequent to the splitoff point.” A. Yes.

Q. Even this suggests only charging these costs subsequent to the splitoff point? A. Yes.

Q. In co-products you do not start at the split-off point, do you?

A. Theoretically you do.

Q. But in actual practice you do not?

A. In actual practice you do.

Q. That is your theory?

A. Yes. The only thing is with respect to co-products, they do not really use the word “split-off,” because the co-products generally begin the process of manufacturing at, let us say, the receiv-

(Testimony of George A. Maxwell.)

ing department of the plant; but that is the split-off point with respect to even the primary product, because the raw material in the primary product is probably the finished material in another plant. So that even at the inception of manufacture of a primary product, that was really the splitoff point. And then when you come to a so-called byproduct, which [1133] does not arise until a number of processes have been gone through, that point is really the inception of the manufacture of that product, and for convenience it is referred to as the splitoff point because it takes its raw material at that point, its raw material being in consequence of what processing is taking place prior to that in the raw material included in the primary product.

Q. Let me give you this situation: Supposing a person has a mine where gypsum is mined, and in connection with that he has a plant where two products are produced, gypsum wallboard and gypsum plaster. A. Yes.

Q. Those are two co-products? In other words, the gypsum, as it comes from the quarry, is ground and dried and it is either taken to be made into wallboard or taken to be made into the plaster; you would consider those joint products, wouldn't you? A. Yes.

Q. And you would assess in that case, would you not, a cost beginning at the time that that rock is taken out of the mine, wouldn't you?

A. As a matter of fact, that is how it should be done, but that is not done very often, although au-

(Testimony of George A. Maxwell.)

thorities recommend that treatment. In other words, it is regarded as a conservative practice and regarded incidentally as the best practical practice, to begin assembling the costs on so-called by-products [1134] at the point of separation. However, that does not alter the fact that there are costs attaching to that by-product prior to that.

Q. I was talking about a co-product, then, Mr. Maxwell.

A. Well, there is no difference between a co-product and a by-product as to the accountant. They are one and the same thing. They are synonymous.

Q. And you contend that this book makes no distinction between co-products and by-products so far as cost accounting is concerned?

A. Well, it does.

Q. You do not agree with the book then?

Mr. Rosenberg: Just a moment. Let the witness finish his answer.

Mr. Bennett: I am sorry counsel. I was too fast. I did interrupt.

The Court: You must allow for the heat of the battle here.

Mr. Bennett: I am trying to move too fast.

The Witness: I would say even the book would be better if it made no distinction.

Q. And the fact that the book makes a distinction, you do not like the book?

A. No. I do like the book, but the book makes a distinction between by-product and the word co-product, which are so frequently used in conversa-

(Testimony of George A. Maxwell.)

tion and in discussing the products of a [1135] manufacturer, but they are nevertheless one and the same thing.

Q. None of these first six methods that they say are available for cost accounting of a by-product is employed at all in the chapter dealing with accounting for co-products, isn't that correct?

A. The authors say they find these methods in existence, very loose methods in existence. They have merely recited the methods they have encountered in their experience.

Q. There is another thing I wanted to cover here. I am going back to the book again, page 506. One of the methods suggested by this book is the total cost less value of by-products method; isn't that one?

A. That is one method, yes. Now he is referring there is the primary product.

Q. That is method No. 4, isn't it?

A. Yes.

Q. Now, he says there, "This method is an improvement over the prior methods by charging the by-product for selling and administrative expense and also for production costs subsequent to the splitoff point. In the manufacture of coke, for instance, the main product (coke) is charged for all costs up to the splitoff point, and subsequent costs are charged to each product as incurred."

A. Yes.

Q. "The net yield of the by-product (sales less cost) is then [1136] treated as a reduction in the

(Testimony of George A. Maxwell.)

cost of coke produced. Simple cost classifications make possible the determination and allocation of subsequent costs."

Then the next page and continuing, the book states, "In figure 3," which figure is below here as a detailed breakdown, "it is assumed that the joint cost—" "joint cost" is equivalent to what we are talking about as overhead, isn't it? A. Yes.

Q. "It is assumed that the joint cost is \$8,500, and the subsequent costs are \$500 for the main product and \$600 for the by-product. These figures make up the total production cost, which is therefore the same as in previous illustrations. Since the joint cost—(overhead)—" "is charged entirely to the main product, the by-product inventory, when valued at cost, carries only subsequent costs. Thus the unit by-product inventory value is \$600 divided by 2500 units, or \$.24. This is the figure used in valuing the inventory of the by-products in the illustration."

The illustration shows down here that the joint costs or the overhead is all charged up to the main product.

A. Oh, no, it definitely does not show that because you did not read this right. This says, "Since the joint cost is charged entirely to the main product, the by-product inventory, when valued at cost, carries only subsequent costs."

Now, that does not mean only direct labor and material. [1137] In this particular instance, coke is the primary product. If gas was the primary prod-

(Testimony of George A. Maxwell.)

uct, then coke would be the by-product, and you merely reverse the situation.

Q. In this instance, you have agreed that overhead, as we have been talking about it, is the same as the author of this book speaks of joint costs?

A. Definitely not. I was in error on that. The joint costs here are the sum total of all costs incurred by the plant. That is precisely the meaning attached to that word here, and he is dividing them between both. In other words, he is taking all the costs, direct and indirect, and he is charging them to the main product here, which is coke, and then he relieves that cost of all subsequent costs attaching to coke, which he is treating as the by-product again, the inference being that all that remains is the cost of the coke, which is the primary product.

Q. But he says the joint cost or the overhead is charged entirely to the main product.

A. No, the joint cost there is the sum total of the costs of all products, which are all put into one pot, so to speak.

Q. Let us see by following the illustration if we do not actually get what he is talking about:

“Sales main product (1,000 units at \$10) \$10,000.

“Cost of sales:

“Joint cost (charged to main product) (1200 units), [1138] \$8,500.”

A. Yes, that is all expenditures.

Q. Yes. A. Not overhead.

Q. It is the joint cost, isn't it?

(Testimony of George A. Maxwell.)

A. Which is direct and indirect. The overhead is only part of that joint cost.

Q. Yes, but included in the joint cost is the overhead? A. Definitely, yes.

Q. And all the overhead is charged to the main product coke?

A. Yes, and then they take it out again and they credit for the by-product.

Q. Let us see if they take it out. I am not going to take time, Your Honor. Would Your Honor like to read this?

The Court: No. Counsel wants to see it.

Mr. Bennett: All right. I will have to go through it.

Q. "Joint cost (charged to main product) \$8,500.

"Subsequent costs main product \$500.

"Total charges to main product \$9,000.

"Less net yield from by-product:

"By-product sales, \$600.

"By-product inventories, \$360.

"Total by-product values, \$960.

"Less subsequent cost to produce, \$600."

And then they have deducted the selling and administrative [1139] expenses of \$80, showing "Total Costs and Expenses \$680," and the net yield of the by-product is \$280, isn't it? A. Yes.

Q. And the net production cost of the main product is \$8,720? A. That is right.

Q. Is that right? A. Yes.

Q. You agree that in that system employed in the coke situation——

(Testimony of George A. Maxwell.)

A. Yes, but you will find that book does not recommend that system. That is the system they find in operation. There he has deducted the sales value of the by-product from the total joint sales. No accountant recommends that who understands his business.

Q. Let me see what they say about this particular method we are talking about. They say it is an improvement over the first three methods.

A. Yes, the first method is the worst and has no basis in reason whatsoever.

Q. And they commend it for this reason, that simple cost classifications make possible the determination and allocation of subsequent costs. In other words, the book commends that method at least, doesn't it?

A. No. I think if you will look at those figures you will see that the subsequent costs attaching to the product were not [1140] deducted from the joint costs, but rather the sales value. I think, if I remember the figures you read, the cost of the by-product was supposed to be \$600 there, whereas they deducted \$280, which was the sales value of the by-product, from the total costs, isn't that correct?

Q. That is right.

A. That has no basis in reason whatever.

Q. This indicates that they determine the actual costs necessary to produce the by-product at \$600. They deducted, or rather, they added the administrative and selling costs of the by-product and the

(Testimony of George A. Maxwell.)

total cost was \$680, or a net yield figured for the by-product of \$280. A. Yes.

Q. But the point I wanted to make in that method, the allocation of plant overhead was allocated to the main product and not to the by-product?

A. No, it was included in the subsequent costs. If it is not, then those are not subsequent costs because the overhead is a part of the costs.

Q. You just assume that. There is nothing in this method that suggested that, is there?

A. No, I think that is axiomatic.

Q. Now we come down to the final method, the last one that is mentioned here, and all that is said about that is as follows on page 522: [1141]

“Another method of byproduct accounting is to charge each product for costs subsequent to the splitoff point, and to apportion the joint costs between the major and byproduct on some acceptable basis. Some authorities consider this method superior to the others, but there is no logical basis for this view, except the fact that a cost is attached to each product.”

A. Yes, the Treasury Department also recognizes that method where a better one is not available.

Q. You dispute, then, what the author says about it, what the book says?

A. No, but I would like to have the opportunity to read something from that chapter myself.

Mr. Bennett: The witness volunteered what the

(Testimony of George A. Maxwell.)

Treasury Department recognizes and I was talking about this book. I move to strike the reference to the Treasury Department.

The Court: The question and answer may stand. The objection is overruled.

Redirect Examination

By Mr. Rosenberg:

Q. You said there was something you would like to refer to, Mr. Maxwell?

A. I have difficulty finding what I am looking for.

Q. (By the Court): What page are you on?

A. Page 524. [1142]

A. Perhaps I should read this section, here. That is headed, "Summary of Methods of By-Products Accounting," if I may.

Mr. Bennett: Where are you reading?

A. Page 523.

Q. (By Mr. Rosenberg): Go ahead and read what you want to read, Mr. Maxwell.

A. Well, it says,—

"The first two methods of by-product accounting discussed above, 'Other income,' and 'Total sales less total costs,' cannot be seriously considered as representing a solution of the problem of jointly incurred costs of production, especially since the by-product entries are made only at the time of sale rather than at the time of production. The next three methods, consisting of adjustments to the joints costs in various forms, are sometimes referred to as market value methods.

(Testimony of George A. Maxwell.)

“The next cost of the major product is determined by deducting from total costs the recoverable values of the by-products. These values are determined in one of the three following ways”——

Q. (By Mr. Rosenberg): Stop right there: Under those methods do you determine cost of production for the by-product or are those methods where a formula is suggested for crediting against the cost of the main product the cost of the by-product?

A. It winds up, as a matter of fact, by pointing out that the [1143] cost of the by-product should be ascertained and credited against the cost of the primary product, or, rather, it describes that as a method.

Mr. Bennett: The witness is not reading. He is merely giving his own impressions.

The Court: He is an expert witness.

Mr. Bennett: All right.

Mr. Rosenberg: I see the grand jury is here. I will not ask any further questions.

(Recess.)

The Court: Since we have been reckless with our time up to this point, the Clerk informs me the matter can go over until Friday.

Mr. Bennett: I will stipulate that this next witness Mr. Rosenberg intends to call will give the same testimony as the two preceding experts that have testified.

Mr. Rosenberg: That is a Greek gift, your Honor. I don't choose to accept that.

Mr. Bennett: I had that in mind.

The Court: I am going to adjourn today until Friday morning at ten o'clock.

Mr. Bennett: There are one or two matters that are undetermined, of which I spoke to your Honor before; for instance, in this matter of the issue of some \$1500 as to deductions around their chemists, and their contentions are that we owe them [1144] that, and we contend otherwise. I don't feel that this court, in view of the busy calendar it has, should be taken up in trying that issue. I have not yet arrived at any understanding with counsel, but I have a feeling that we can and should in some way dispose of that. I think we can do that.

Mr. Rosenberg: I think we can.

Mr. Bennett: That will leave only the main issue for the court, the interpretation of the contract. There are only two or three paragraphs that have to be construed——

The Court: Nos. 3, 5, and 6.

Mr. Bennett: Yes, No. 3, 5, and 6. The testimony I have will be very brief, and I think it is possible we might finish by Friday noon.

The Court: Then, what is your thought?

Mr. Rosenberg: I will be willing to argue it orally, or to brief it, whichever method the court thinks would best suit the court.

The Court: I might add that unless I change my mind I would be able to dispose of it right now.

Mr. Bennett: I hope your Honor does not mean that adversely to us.

The Court: I say that kindly.

I would like to focus my mind on this problem, that I thought if both sides could simultaneously submit a brief in ten days it would be helpful to me in disposing of this case. [1145]

Mr. Bennett: With the right of reply?

The Court: No reply.

Mr. Bennett: I know your Honor is anxious to dispose of this case. I feel it is a highly commendable attitude, but I think, after all, nothing is settled unless it is settled well, and I want to furnish your Honor as meticulously as I can with material——

The Court: I will not foreclose you from presenting any material you wish.

Mr. Bennett: I will do what your Honor wishes on that, but it does seem to me that we might get things in better shape for a decision by following the usual practice of opening, replying and closing. However, if your Honor has different desires, we will meet those, whatever they may be.

The Court: I never make any pretense of telling counsel who have devoted their time and energies on both sides of any case, what to do. But I had that thought in mind, and I expressed it for what it may be worth.

Mr. Rosenberg: I will be in accord with the suggestion for simultaneous briefs, but frankly I would like a little longer time. This has been a rather arduous trial, and it has involved a lot of work at night in addition to the time in court, and, frankly, I am a little weary, and would like

a few days' respite before jumping into the thing again. [1146]

The Court: Very well. Then you may have 10, 10 and 5.

Mr. Bennett: That would be after this case is completed?

The Court: We are going to complete it Friday morning.

Mr. Bennett: Yes, I think so, Your Honor. I have a couple of short witnesses.

Mr. Rosenberg: Before we adjourn, and before I forget it, I would like to get into the record this matter. Mr. Bennett asked me to provide him with the figures on the production of ethyl-dibromide at this plant during the periods in question. I have that information and I have given it to Mr. Bennett. He also asked for the laboratory report that was made on this test where they processed gypsum in the plant, that is, tested for the purpose of determining whether they could produce gypsum without the use of sulphuric acid. I have brought in that report for Mr. Bennett. If he wants that to go into the record I am perfectly willing that it should go in. But I want the record to show I made that offer.

Mr. Bennett: I don't consider that report of the laboratory any report at all.

The Court: At any event, let it be marked for identification.

Mr. Bennett: Are you willing to offer these in evidence?

Mr. Rosenberg: You asked for them.

Mr. Bennett: I wanted the laboratory report in connection with the corss-examination of your chemist, but that now seems [1147] impossible. If you want to offer that in evidence, I will not object, but I do not want to be bound by that.

Mr. Rosenberg: Then I don't see any purpose in putting these in.

The Court: Well, it was asked for.

Mr. Rosenberg: I will put them in then. The laboratory report will be offered as our next exhibit in order.

The Court: Let it be marked for the purpose of identification.

(Laboratory report in question was marked Defendant's Exhibit L for identification.)

Mr. Rosenberg: This next one should go in evidence. That is something Mr. Bennett asked for. In this next document are figures on the production of ethylene-dibromide.

Mr. Bennett: Now, nothing is shown as to value. I understand this is worth something like \$2,000.

Mr. Rosenberg: I don't like to be unkind, Mr. Bennett, but if your information is so completely erroneous——

The Court: Out of line——

Mr. Bennett: Out of line, yes. It may be, I don't know. Can you supply me at this time with market values of these ethylene-dibromide figures which are listed on this yellow sheet that you are now offering in evidence during those periods of time?

Mr. Rosenberg: I will get that for you. [1148]

The Court: Very well. Let that document be marked in evidence.

(Yellow sheet containing figures on ethylene-dibromide was thereupon marked Defendant's Exhibit M in evidence.)

DEFENDANT'S EXHIBIT M

ETHYLENE DIBROMIDE PRODUCTION

July 1, 1945	July 1, 1944		
June 30, 1946	June 30, 1945	Year 1943	Year 1942
271T	719T	485T	507T
July 1, 1940	July 1, 1939		
June 30, 1941	June 30, 1940	Year 1938	Year 1937
592T	550T	445T	341T

The Court: We will stand adjourned until Friday morning at 10:00 o'clock.

(Thereupon an adjournment was taken in this matter until Friday, January 2, 1948, at 10:00 o'clock a.m.)

CERTIFICATE OF REPORTER

We, Official Reporters and Official Reporters pro tem Certify that the foregoing Transcript of Record pages is a true and correct transcript of the matter therein contained as reported by us and thereafter reduced to typewriting, to the best of our ability.

/s/ J. J. SWEENEY,

/s/ F. J. SHERRY,

/s/ KENNETH G. GAGAN. [1149]

Friday, January 2, 1948, 10:00 o'Clock A.M.

DeWITT ALEXANDER

called as a witness on behalf of defendant; sworn.

The Clerk: Give your name.

A. DeWitt Alexander, also known as A. DeWitt Alexander.

Direct Examination

By Mr. Rosenberg:

Q. Where do you live, Mr. Alexander?

A. My residence is Berkeley, California.

Q. What is your profession?

A. Certified public accountant.

Q. Since when have you been a certified public accountant?

A. September, 1921, in the State of California.

Q. Will you give us a brief outline of your experience since the time you were certified as a public accountant?

A. I have been in public practice in public accounting since 1919—well, since I received my certificate, as you say. I was a partner of the firm of Robinson Nowell & Company, in San Francisco, from 1925 until 1943. Since 1943 I have been with Peat, Marwick, Mitchell & Company, public accountants and auditors. And for the last year and a half I have been resident partner of Peat, Marwick, Mitchell & Company in San Francisco.

Q. That is a national firm of certified public accountants, is it?

A. It is a national firm and international firm, the American [1150] firm having 40 offices in North America.

(Testimony of DeWitt Alexander.)

Q. You are a partner of that firm and the resident partner in charge in San Francisco, is that so? A. Yes.

Q. What are your functions as resident partner of that firm?

A. I am responsible for the activities of the office, for keeping up our professional standards, keeping informed, myself, of up-to-date professional knowledge and carrying out that responsibility.

Q. What societies do you belong to or have you been a member of?

A. I have been a member since about 1923 of the American Institute of Accountants and the California Society of Certified Public Accountants.

Q. Have you had any experience in cost accounting, Mr. Alexander?

A. I have had a very varied practice, if I may say so, and it has included cost accounting.

Q. That has been over the years, has it?

A. Oh, yes.

Q. I am going to ask you to assume the existence of a chemical plant which is recovering from a common raw material three different products, which I will designate as products A, B, and C, and ask you to assume that product B is technically a by-product in the sense that it consists in part of a chemical element which must be extracted from the raw material in order [1151] to produce product C in the pure and salable form, and to

(Testimony of DeWitt Alexander.)

assume that in order to convert product B into a salable commercial product after it is separated from the raw material it is necessary to process it, and for the purpose of such processing a physical plant is required which is devoted exclusively to this processing, and labor is employed which is devoted also exclusively to the processing of the product, and I will ask you to assume further that by reason of a contract it is necessary that the manufacturer determine the cost of the production of product B, and under those circumstances will you state whether or not, in your opinion, it is proper and good accounting practice to include in the cost of production of product B a portion of the plant overhead? A. Yes.

Q. And under the same assumed circumstances would it be proper and good accounting practice to include in the cost of production of product B a portion of the indirect charges of the plant, such as general superintendence and other charges for labor which are devoted to the production of the several products, including product B, but as to which it is impossible or impracticable to keep records of the actual time devoted directly and exclusively to each of the particular products?

A. Yes.

Q. Having in mind the same assumed circumstances, would you [1152] say that it would be improper to include in the cost of production of product B any charges which would continue, notwithstanding that the production of product B were

(Testimony of DeWitt Alexander.)

discontinued, although in some lesser or unascertainable amount? A. Improper? No.

Q. Under the same hypothesis, Mr. Alexander, I will ask you to assume that a shipping department is maintained in this plant from which products A, B and C are shipped, and that the direct labor that is employed in the handling and shipping of each of the three products is accurately recorded by time card and is charged directly to the respective products on which the labor is performed, but that the expenses of foreman, assistant foreman, shipping clerk, demurrage, and tractor expense in connection with the handling of the products is allocated between the three products in the proportions that the tonnages of the three respective products bear to the total tonnage shipped. In your opinion would that be good and proper accounting practice?

A. You stipulate there that the tonnage is fairly representative of the allocation? Yes.

Q. It is allocated on the basis of the tonnage handled of the three respective products.

A. Yes, normally so. There might be exceptions as to the method of allocation.

Q. Would there be any question in your mind that these expenses [1153] that I have mentioned of the foreman and the assistant foreman, and so forth should be allocated to the three products handled on some proper basis? Is there any question about that? A. No question, whatever.

(Testimony of DeWitt Alexander.)

Q. Will you state this, Mr. Alexander, as a general proposition: In the case of the production of a by-product which requires some physical plant and some direct labor in order to make it a commercial product and salable as such, as a general product, is there any reason in your opinion for employing any different methods or principle in determining the cost of production of that product than you would employ in the case of what are commonly designated as co-products or joint products?

A. No, I accept as a principle that all the proper and accepted methods of accounting are equally applicable in the case of a joint product or a by-product, the only difference being due to necessities and expediencies.

May I say this: I could be challenged on that statement, but not if I say for the purpose of by-product accounting all the good and proper methods are sound until expediencies and necessities become the proper and sound thing to do in lieu of actual cost determination.

Q. You mean by that it is not uncommon for other accounting methods to be employed in the case of by-products?

A. You say it is not uncommon? It is very common to use expediencies. [1154]

Q. What expediencies, for instance?

A. Oh, crediting the sales to the cost of the main product, crediting sales to miscellaneous income—pure expediencies.

(Testimony of DeWitt Alexander.)

Q. But do those expediencies result in determining the cost of production of a by-product?

A. Oh, they are not a determination of the cost of a by-product at all in any sense.

Q. Why are those methods employed in some instances?

A. Well, I frequently put it this way: The very cost of pushing the pencil to determine the cost is not worth the trouble.

Q. In the case which I have assumed, where by contract it is incumbent upon the manufacturer to determine cost of production, is there any question in your mind and in light of your experience as to what is the proper accounting method to be employed in determining cost of production?

A. No, provided, of course, that the by-product is not so minor that your costing becomes a little dubious as to its accuracy. That would be the case in the case of a by-product whose value was .1 of 1 per cent of the main product, or something of that sort. You would be getting into extremes.

Q. Are you familiar with the manufacturing processes of the Westvaco Chlorine Products Company at its Newark plant? A. Yes.

Q. Have you had occasion to visit that plant and to acquire some familiarity with those processes? [1155]

A. Yes, I visited the plant and I have been through it, I would say, if I may be permitted to do so, fairly thoroughly twice.

(Testimony of DeWitt Alexander.)

Q. Have you familiarized yourself generally with the production of gypsum in that plant?

A. Yes.

Q. Will you state whether or not in your opinion, and assuming that it is necessary for Westvaco Chlorine Products Company to determine the cost of production or cost of manufacture of gypsum, would you state whether or not the accounting methods to be employed would or would not be those that you have stated in these hypothetical questions to be properly applicable to product B?

Mr. Bennett: Just a moment. Your Honor, I do not want to delay this any more by objection, but it seems to me that that is a situation of injecting elements that have really not been before the court. The witness, an expert witness, is asked, "Did you go down and examine the plant? Do you think this method is proper?" That has two vices, as I see it: One that enables him to base an opinion on facts upon which neither counsel nor the court knows of their knowledge, because of not having had the opportunity of determining precisely on what elements he bases such an opinion, and that is why in the case of experts the proper and customary practice is to state a hypothetical situation, stating certain [1156] elements upon which such expert testimony is given. I object to this question on the ground it is incompetent, irrelevant and immaterial.

Mr. Rosenberg: I think the witness has stated that he is familiar with the processes there. He is

(Testimony of DeWitt Alexander.)

subject to cross-examination, if the Court please. If he does not have the proper background I am sure Mr. Bennett is competent to bring that out. I am perfectly willing to ask him to describe the processes there upon which he based the opinion that I have asked him for, if the Court would prefer. I will withdraw that question.

Q. Mr. Alexander, will you just describe in a general way the processes at the Newark plant, the manufacturing processes there, that is, the physical things that you have observed there and the things that you know about the manufacturing processes at the plant?

A. You say in a general way?

Q. Yes, just in a general way.

A. Well, I have observed the settling tanks where the magnesium sulphate is brought in and the calcium chloride added, and I have observed the process by which after the calcium sulphate, the gypsum, which as I understood it is hydrous calcium sulphate, has been withdrawn out of the settling tanks and put through the drying and grinding or partially grinding and other processes in the gypsum plant down to the shipping and packing. [1157] And I have observed the magnesium side of the plant and have had the processes described to me. I have observed from an exterior angle the rotary kilns, the kilns in which magnesium oxide is prepared from the magnesium chloride and the packaging and processing of them.

(Testimony of DeWitt Alexander.)

I have said something packaging of gypsum. It is not packaged. But I have seen the packaging of the magnesium. And I observed in a general way, not as a plant superintendent, but as an accountant will, to gain an idea of the extent of the operations, the gypsum plant, and I find it is essentially what I would call a factory stuck in the middle of the magnesium plant. I can't say whether in physical magnitude it is one-quarter, one-half or one-eighth, as an engineer might measure it, of the magnesium plant. But I did observe from an accountant's point of view, with special reference to the operations in the gypsum plant, it is a material manufacturing plant in the same location.

Q. Upon that background——

Mr. Bennett: Just a moment. I think I should move to strike the witness' conclusion or his statement that it was a factory within a factory, that it was a material factory, and of substantial extent, and so forth, as a conclusion and opinion of the witness that the witness or anyone else visiting the plant would not be permitted to draw upon.

Q. (By the Court): You observed this while you were down there? [1158]

A. Yes, and I have already said I am not a plant operator.

The Court: It goes to the weight of the testimony. I will allow it. Proceed.

Q. (By Mr. Rosenberg): Upon that basis, Mr. Alexander, will you state whether or not, in your expert opinion, in determining the cost of the pro-

(Testimony of DeWitt Alexander.)

duction of gypsum, and it being obligatory upon Westvaco to do so, whether or not the accounting methods that you have testified as being proper to apply in the case of the hypothetical product of B would be applicable in the case of the gypsum?

A. Yes, and may I be permitted to say that this observation of the extent of the processes is one factor. The economic value of the total output of gypsum compared with the magnesium, the extent of processing, the number of employees, the cost of those employees, such other facts as the availability of bookkeeping staff to carry out the proposition—all those factors, and I could name their importance in order, including observations of the physical processes—based upon all that I would unquestionably say that they could and should keep complete cost accounting of the so-called by-product gypsum.

Q. And would that include overhead and indirect charges of the nature that we have been discussing?

A. Yes, definitely. I do not see the warrant for the expediency of omitting those. [1159]

Q. Directing your attention to Plaintiff's Exhibit 18, Mr. Alexander, and particularly the third page entitled "Overhead and General Plant Expense," you have had an opportunity to inspect that prior to the time of taking the witness stand, have you?

(Testimony of DeWitt Alexander.)

A. This appears familiar; yes, in a general way.

Q. Will you state whether or not you consider the items that are included on that sheet in making up the aggregate overhead expense, proper items of overhead expense to include in the cost of production of gypsum? I am not speaking of amounts now. I am merely speaking of items as items of overhead expense.

A. Yes. I think I should add that my answer is affected a little bit by further inquiries beyond what I have seen here. Yes.

Q. Just one further question. Will you state whether or not, in your opinion, you consider it proper to use the straight line method of depreciation of equipment, such as the equipment in the so-called gypsum plant, by which I refer to the equipment that is used exclusively in the processing of the gypsum? A. Yes.

Q. Would you consider it proper to depreciate that on a straight line basis? A. Yes.

Q. Will you state on what you base your opinions that you have [1160] expressed, Mr. Alexander?

A. In the first place, depreciation is one of the most difficult things in all accounting to determine, and while I would hesitate to say whether straight line depreciation is used in 90, 95 or 99 per cent of all accounts that we examine, nevertheless it appears to be the best way of determining depreciation that we have before us in most cases.

(Testimony of DeWitt Alexander.)

In this particular plant—and I have had a little prior familiarity with plants in that same locality dealing with salt—and based on information that I have obtained there, it is quite obvious that the apparatus and other equipment at this plant primarily has a useful life based upon the time element. It is subject to very heavy corrosion. It is not to be compared with a machine tool, where a good industrial engineer would perhaps estimate it would produce so many items. Not this equipment. From all the information I could gather it wears out on a time basis, which calls for what has been spoken of—it has been used in this courtroom—straight line depreciation.

Q. The opinions generally that you have expressed from the witness stand this morning, on what do you base those opinions?

A. You are speaking of the theoretical question of accounting?

Q. The hypothetical questions, yes.

A. Based upon my experience, on previous thinking and analysis of the costing of so-called by-products, supported by research [1161] which I have had made under my direction at this time to see whether the authorities would agree or not with my pre-existing ideas of so-called by-product accounting.

Mr. Rosenberg: No further questions.

The Court: We will take a recess.

(Recess.) [1161-a]

(Testimony of DeWitt Alexander.)

Cross-Examination

By Mr. Bennett:

Q. You have been in the courtroom most of the time since this case has been on trial, haven't you?

A. Not most of the time, but I suppose most of the time when the accounting testimony has been carried on.

Q. You have been the auditor in the employ of the defendant covering a period of years, for the last several years in connection with this controversy that has existed between the defendant Westvaco on the one hand, and Pacific Portland on the other.

A. My firm has been employed by the company in its New York office and with the assistance of our office (and other offices, I presume), has been the auditor of Westvaco.

Q. You personally have had some knowledge of this controversy that has existed between the plaintiff and the defendant involved in this case some time previous to the actual trial of this case?

A. My first knowledge of this case was when I returned from the East, November 16, 1947.

Q. And from that time you collaborated with the defendant's counsel in preparing this case for trial?

A. Yes.

Q. As I understand, you would treat the matter of gypsum here just as you would a primary or co-product production?

A. Yes, unqualifiedly. [1162]

(Testimony of DeWitt Alexander.)

Q. And not treat it in any respect as a by-product?

A. There has been so much said about by-product here that I would like to have a definition of it before I answer that question.

Q. Without going into detail, as I understand it, you would treat, so far as the determination of costs, gypsum just as you would a primary or a co-product manufacture, wouldn't you?

A. Yes.

Q. And that has been the basis and the advice you have given the defendant and the testimony that you have given on the witness stand?

A. Yes.

Q. I suppose that you would also agree with the testimony of the witnesses Farquhar and Maxwell?

A. Yes.

Q. In other words, on this item of depreciation you would approve the so-called straight line method of depreciation because of the corrosion factor, is that correct?

A. I would approve of it because it appears to be the best available method in this case, and that is greatly strengthened by the factor of heavy corrosion.

Q. Suppose you rule out completely the corrosion factor and take into consideration the particular facts of this case where a comparison of costs of production in the manufacture of gypsum in two related twelve months periods would effect a price [1163] increase per ton from the manufac-

(Testimony of DeWitt Alexander.)

turer, Westvaco, to the purchaser, Pacific Portland Cement Company, if and when there was an actual advance in the cost of manufacture in those comparative periods: assuming under those circumstances there was no question of corrosion; would you still say the straight line method would be the proper one to employ?

A. I assume so, if estimating the useful lives of the two different periods had been fairly determined. May I add to that, I don't know the exact reason for the alleged increase in depreciation here, but if for outside reasons less is produced in the same plant as had been in the earlier years and other conditions were the same, it is obvious the cost of use of that plant—if I may use that term, although it is not an accounting way to express it—that cost will have increased per unit.

Q. If, in other words, a manufacturer for some reason of his own or by reason of some change of circumstance of the use of products that would facilitate or further the production of magnesium to the extent of the plant capacity, but at the same time the production of the gypsum which is taken out of the raw materials and goes on to produce magnesium oxide would be reduced to half; that would arbitrarily, would it not, increase the depreciation charge per ton of gypsum 100 per cent?

A. That would increase it 100 per cent. Let us understand each other, though, as to what we mean by "arbitrarily."

(Testimony of DeWitt Alexander.)

Q. If the tonnage went back up to its previous production, the [1164] depreciation charge would pay for all the machinery, wouldn't it?

A. Would you please say that again?

Mr. Bennett: Will you read the question?

(Question read.)

Mr. Rosenberg: Over what period of time? That is the purpose of depreciation, to depreciate a piece of property over its life.

Mr. Bennett: I think that is perhaps a matter of argument.

Q. But, in any event, and in the next year the production was brought back to its normal, say, of 20,000 tons where it had been dropped the preceding period to 10,000 tons, by this application of increased price it would greatly add to the depreciation charge for that particular year, wouldn't it?

A. You are speaking of the results?

Q. Yes. A. Yes.

Q. The thing we are endeavoring to determine is the unit cost per ton under the situation I have given you and I am trying to speak now not for a situation where only the manufacturer is concerned, but the situation I gave you where a purchaser's price was to be effective per ton above a stipulated contract price, and if there is by reason of the decrease in production a corollary increase of 100 per cent in depreciation rate for that year, and that is carried on into the next year as an added cost of production because of that application of straight line [1165] method of deprecia-

(Testimony of DeWitt Alexander.)

tion—that is correct, isn't it?

A. I don't quite understand that; but in that subsequent year wouldn't the cost per unit go down?

Q. Well, the price does not go down in the situation I am giving you, Mr. Alexander——

A. That is because of the terms of this contract, isn't that right?

Q. Yes.

A. Am I permitted to say that the interpretation of the contract in those respects is not my concern?

Q. No, you are dealing with the situation that affects the manufacturing itself, is that right?

A. I was trying to give, and I hope I gave it correctly, a picture of the accountant's best procedure in respect to depreciation charge determinations.

Q. And not in relation to any special situation posed by a contract that might be involved.

A. No, a contract might say specifically that depreciation was not a part of the cost.

Q. And it might contain other situations or conditions that would change or influence your opinion in that respect.

A. Pardon me?

Mr. Bennett: Will you read the question?

(Question read.)

The Witness: Yes. [1166]

Q. (By Mr. Bennett): As provided by contract.

A. Oh, yes, we could have innumerable clauses in the contract.

(Testimony of DeWitt Alexander.)

Q. You stated, as I understood it, that you would include a proration or allocation of all of these items of "overhead and general plant expense" that appears on a page entitled "Overhead and General Plant Expense" in Plaintiff's Exhibit 18. You would do that irrespective of the fact that no attempt had been made to allocate individually the items even in the case where the items were grouped together and you would take the total.

Mr. Rosenberg: That is assuming a fact not in evidence.

Mr. Bennett: In connection with counsel's objection, Your Honor, I will read thereon a note appended to this page:

"Only a few of these component items are individually allocated on the books. In the actual accounting most of the overhead items are grouped and the aggregate is allocated to the various products produced. Therefore, any attempt to allocate each individual item is somewhat hypothetical. However, the totals accurately reflect the aggregate overhead actually charged to gypsum during the years in question. The comparison has been made on this basis at the request and for the information of Pacific Portland Cement Company."

Mr. Rosenberg: But that shows they were allocated in that way from individual records. They were not set down like one piece of carbon paper or one ream of writing paper, but they [1167] are actual records and the amounts are set forth by the books itemizing each individual item. If you

(Testimony of DeWitt Alexander.)

want to go back and go to the trouble and labor and expense of going from the books to the original records, the original records would support the books.

Mr. Bennett: Well, the point is that this language speaks for itself, and as I read it, with the exception of a few, all of these items are grouped as the statement that you prepared states and the aggregate of that group is allocated to the various products produced, including gypsum.

Q. You would still, nevertheless, allocate an aggregate of all of these items, would you, Mr. Alexander, without any reason as to how or in what way the particular items specifically had to do with the production of gypsum?

A. Yes, but may I add that the accountant's aim within the realms of practicability is to subdivide his groupings. It is all a question of allocability and it is very common and it is very sound to take the whole aggregate and allocate it on some rational formula.

Q. That involves in a sense an arbitrary allocation?

A. In a sense, an arbitrary allocation, yes.

Q. And it may include, say, 5 or 10 or 20 per cent of an allocation of an item that may in actual fact have little or no relation to the actual production of a particular product at the plant? [1168]

A. Yes, if I may be permitted by His Honor to digress for a moment, I have heard something in this courtroom where I found a little misunder-

(Testimony of DeWitt Alexander.)

standing not only in the courtroom but outside. If I may use a homely illustration, if you take 10,000 bushels of wheat from Farm A and take 10,000 bushels of wheat from Farm B and put them into a grain elevator, you have then what you attorneys know as fungible goods; and let us say half of that wheat goes to Chicago and half of that wheat goes to Kansas City. It is not fair, or it is not proper after that to say that half the wheat from Farm A went to Chicago and half to Kansas City. Have I made it clear?

Q. You have made it clear, so far as that example is concerned, but I don't understand that that is involved at all in this case.

A. I don't mean to digress, but if you take an aggregate and allocate it, it is not proper to take one item of the total and say a part of that has been allocated to one item or another.

Q. But that is when you are dealing with practicability and convenience and determining for the purpose of the manufacturer his cost. Is that what you mean?

A. No, that procedure of going as far as practicable will allow the making of a rational allocation of all your overhead and has been found acceptable in accountancy experience and has been used consistently in accounting under cost plus contracts and without any question, I think I may say. [1169]

Q. That is according to your view of it. Let me ask you one or two more questions.

(Testimony of DeWitt Alexander.)

A. You say, "according to my view"—I had in mind the manual of the War Department and the Navy Department on the subject.

Q. That is merely where the price to the government is based on cost plus a certain increment of profit, isn't that so?

A. Usually, yes, but the pamphlet does not specify that type.

Q. And in cases where the elements of cost are usually divided and specified in the contract, too?

A. No, they are not usually divided.

Q. Take the case of research for new products and assuming that this research is directed to finding a new product to be made out of this calcium sulphate, which with two molecules of water and after drying and grinding forms gypsum, which is sold to the Pacific Portland Cement Company where the research, as I say, is devoted to finding some other product to manufacture out of this calcium sulphate which is drawn from the main product in order to manufacture the oxide. Will you consider that that research cost or a portion of it should be allocated in the situation that I gave you to gypsum where such allocation would, if it increased in any comparative twelve-month period, would increase the cost of production or manufacture of gypsum?

Mr. Rosenberg: To which I object on the ground the evidence is uncontradicted, if Your Honor please, that so far as [1170] new product research is concerned, is confined and devoted to research

(Testimony of DeWitt Alexander.)

for new products from bittern, not from magnesium sulphate.

Mr. Bennett: One of your witnesses, Mr. Wallace, I believe, stated that part of this research had to do with finding some new methods or use of this so-called waste material, the sulphate that is taken out of the magnesium to produce a product other than gypsum which obviously could in no way benefit the plaintiff in this case.

Q. Would you consider it proper in the situation I have given you, to allocate a portion of that research to the actual cost of manufacture of gypsum?

A. You are speaking of research and you don't mind if I repeat this, you are speaking of research under which the hydrous calcium sulphate, the gypsum, will be used for a different purpose than gypsum?

Q. Yes.

A. Oh, no, that is not a proper charge. That is a new and major development of the company.

Q. Even though one of those items is allocated by aggregate——

A. For a specific new development like that, I would say no; but please understand, it is that specific thing that I would not allocate.

Q. Let us take the item listed here under "West Coast Subscriptions and Donations." Where there is a new and major development of the company. be affected by any of the cost of manufacture of gypsum, would you allocate a portion of the dona-

(Testimony of DeWitt Alexander.)

tions and subscriptions to West Coast that the defendant sees fit to donate or give?

A. Yes. While it is quite possible they might go to excess, I would say the accountants today generally recognize a certain amount of donations and even more so, subscriptions are necessary and normal for the conduct of a business enterprise.

Q. That is so far as the working out of some system of allocating costs for the sole purpose of the manufacturer himself?

A. No, we included it in our cost for all purposes.

Mr. Bennett: That's all.

Redirect Examination

By Mr. Rosenberg:

Q. Just on that last subject, Mr. Alexander, would you say that donations and subscriptions in an annual amount of \$51.55 charged to gypsum which is too small to even affect the unit cost of gypsum would be an excessive amount to include in general overhead?

Mr. Bennett: That is not proper. Well, I will waive the objection.

A. No, and I don't think you would have to be an accountant to answer no to that question.

Mr. Rosenberg: Defendant rests.

(Defendant rests.) [1172]

Mr. Bennett: I feel, Your Honor, if I can rush through we will probably be able to finish after this witness and another.

The Court: Very well.

J. HUGH JACKSON

called as a witness on behalf of plaintiff in rebuttal, sworn.

The Clerk: Will you state your name to the Court?

A. J. Hugh Jackson.

Direct Examination

By Mr. Bennett:

Q. What is your present occupation, Mr. Jackson?

A. I am professor of accounting and dean of the graduate school of Business at Stanford University.

Q. How long have you been professor in accounting at Stanford University?

A. I have been there for 21 years.

Q. How long have you been dean of the graduate School of Business Administration?

A. This is my 17th year.

Mr. Rosenberg: Now, just a minute. Do I understand you are going to put on some more expert testimony?

Mr. Bennett: I think that would be the nature of this evidence.

Mr. Rosenberg: I think that is not proper rebuttal. That [1173] is part of the plaintiff's case in chief and I don't presume that we are going to start now alternating putting on expert witnesses. That was part of their case in chief to put on ex-

(Testimony of J. Hugh Jackson.)

pert testimony. They did that and I put my experts on. I would object very strenuously now to any additional expert testimony which is part of their case in chief and not proper rebuttal. Counsel put his expert testimony on and then I put mine on. If the purpose is to fortify or rehabilitate their experts by further testimony, that is not proper rebuttal.

Mr. Bennett: I think it is, Your Honor.

The Court: I may assist you. I think his position is well taken. Now, so that I am not mistaken about it, indicate for the purposes of the record what this witness is to testify to by your calling him.

Mr. Bennett: Your Honor, this witness is going to be asked the precise question that the defendants put to their experts. He, in his case, has brought certain experts to give testimony on a basis, I think, different in degree than that which we would offer, at least, as to the scope they intend to cover. I only intend to ask this witness two or three questions, one of which is the hypothetical question which I think hardly fits the case, but I am going to ask this witness that question, and I think it is proper rebuttal, and for the further reason that these witnesses have attempted to tell Your Honor about the teaching of the profession and I am going to offer [1174] you a witness here that has not only been the president of the National Institution of Cost Accountants, but has taught this subject and has acted as a special adviser not

(Testimony of J. Hugh Jackson.)

only to national undertakings and societies, but has taught this subject. He will, I think, be able to tell Your Honor something as to the teaching and accepted principles of this profession that I did not go into detail with my witnesses and which I consider direct rebuttal to the line of testimony that has been offered by the defendants.

The Court: How many questions did you say?

Mr. Bennett: As soon as he is qualified, I think three questions will cover this.

The Court: Counsel should be in an equal position to offer such rebuttal.

Mr. Bennett: He can if he considers it proper rebuttal.

The Court: Since you have indicated you intend to ask only three questions, I will allow this. However, I think counsel's position is a correct one. Both sides had an opportunity to prepare their cases and offer the expert witnesses in relation to the testimony. As a matter of fact, the Court could limit the expert testimony to one or two expert witnesses on each side. You had a full opportunity to put in the case in chief. There may be something in your mind with relation to what has developed here. That is the reason now that I am allowing you to ask these questions. However, in doing that [1175] counsel may have an equal opportunity if he desires.

Q. (By Mr. Bennett): Will you please state your education, training and experience, and memberships in societies having to do with business ad-

(Testimony of J. Hugh Jackson.)

ministration and accounting, and particularly with reference to any field that has to do with cost accounting?

A. I am a certified public accountant of the states of Massachusetts, Wisconsin and California. I spent nine years in professional accounting with the firm of Price, Waterhouse & Company, two years of which I was in charge of all staff training for that organization throughout North America. I have, for 28 years, been teaching accounting, and most of the years have been teaching cost accounting, and 25 of those years have been as a full professor either at Harvard or Stanford University. I have been a member of the National Association of Cost Accountants practically since its inception. It was organized in September of 1919 and I joined in November of 1919. I have served for two years as president of the San Francisco Chapter, for two years as national vice president, and during 1938-1939 as the national president of the Association. Since that time I have been a member of the research committee of the Association. I have also been past president of the American Accounting Association, which is another national association. I am the author of a number of well known books on accounting. I have served as consultant on accounting and [1176] cost accounting and have installed cost accounting systems for a number of years and in a number of various organizations.

(Testimony of J. Hugh Jackson.)

Mr. Bennett: Now, Your Honor, I am going to ask the witness the question that defense counsel asked of Mr. Farquhar. I want Your Honor to understand, however, that I consider the question in a sense too narrow because I am offering this witness in rebuttal to the specific testimony given by the defendant witnesses. I am going to frame my question as near as I can precisely as it was framed by defendant's counsel.

Mr. Rosenberg: What page of the transcript are you referring to, Mr. Bennett?

Mr. Bennett: Page 1083.

Q. Dean Jackson, I am going to ask you to assume that a chemical plant is recovering from a common raw material three different products, which we will designate as products A, B and C. I will ask you to assume that Product B is technically a by-product in the sense that it contains or consists in part of the chemical element which must be extracted from the raw material in order to produce Product C in the pure and salable form. Assume also that in order to convert part of B into a salable commercial product after it is separated from the raw material, it is necessary to process it, and that for that purpose it is necessary to have a physical plant devoted exclusively to such processing. By that I mean, in the main plant there is special machinery and facilities devoted exclusively to the [1177] production, the grinding, drying and further processing of this byproduct. It is likewise necessary to employ labor which de-

(Testimony of J. Hugh Jackson.)

votes itself exclusively to this processing. Assume further that by reason of contract it is necessary that the manufacturer determine or that there be determined the cost of production of Product B. Will you state in your opinion whether under these circumstances it is proper and good accounting practice to include in the cost of production of product B a portion of the overhead of the whole plant.

Mr. Rosenberg: Now, just for the record, I object to the hypothetical question on the ground it is not proper rebuttal and on the other grounds I have previously stated.

The Court: Objection overruled; exception noted.

Mr. Bennett: Will you read the last part of the question to the witness?

(Record read.)

The Witness: May I, sir, Your Honor, state that it seems to me that there should be the point of view with reference to this whole matter of cost accounting that it is being carried on for the benefit——

Mr. Rosenberg: Just a moment. May we have an answer to the question before the witness dissertates? He has been asked a question and he can answer that yes or no.

The Court: You may answer the question yes or no and then make any explanation you have. Read the question, Mr. [1178] Reporter.

(Record read.)

(Testimony of J. Hugh Jackson.)

The Witness: If you mean by overhead of the entire plant which is not directly allocable to this particular product, my answer would be no.

Q. (By Mr. Bennett): Now, will you state your reason for that, Dean Jackson?

A. My reason for it, that I believe the ordinary business man in dealing with a by-product, will deal with the byproduct on the basis of whether or not the byproduct after it comes off from the main product, and I believe from the discussion that I have heard, that had been more or less agreed that there is no charge to the byproduct material at that point of splitoff. From that time the direct labor, the direct overhead, if you want to use that to determine overhead of the additional plant which would be used in processing that byproduct would be a proper charge to the byproduct. But most business men would not include as a charge to that byproduct that portion of the general overhead which would go on just the same whether the by-product was produced or not. In other words, that product must stand on its own feet as to whether or not it will pay the organization to produce that product from the time it is split off from the main product; and if it will not, any sensible business man would not proceed to produce it.

Q. Do you consider that sound accounting for a situation such [1179] as I mentioned to you?

A. What is sound accounting is that determined by best practices of good businessmen, and that is

(Testimony of J. Hugh Jackson.)

the practice good businessmen would follow. My answer is yes.

Q. If these overhead or indirect charges that you say would not have been incurred if no gypsum, which is the product that I am speaking of here as the byproduct, had been produced in lesser but unascertainable amounts, would you include them or not? A. I think I would not.

Q. If there was a situation where the purchaser of this particular byproduct had a long-term contract where the contract provided a stated price subject to being increased if and when the cost of production of the byproduct increased in excess of 5 per cent over the preceding twelve-month period and the contract provides or the management between the parties provides that the increased price shall not exceed the actual advance in the cost of manufacture of the byproduct in the comparative, state whether or not there would be the same, less or greater reason for the exclusion of certain costs that you have indicated should be excluded?

Mr. Rosenberg: To which I object on the ground it is not the proper subject of expert testimony. It is up to Court to interpret this contract and find out what the rights and obligations of the parties are under the contract.

The Court: Objection sustained. [1180]

The Court: The objection is sustained.

Mr. Bennett: I think I have asked three questions, your Honor, and I will not transgress further.

(Testimony of J. Hugh Jackson.)

Mr. Rosenberg: Where are all the authorities this witness was going to bring? I thought you put him on the stand to educate the court on all these authorities that you mentioned. Isn't that the purpose for which you said you wished to produce this witness?

The Court: I limited counsel to three questions.

Cross-Examination

By Mr. Rosenberg:

Q. Did you train Kenneth Pryor when you were with Price-Waterhouse? Was he one of your proteges there? A. No, sir.

Q. You did not train him? A. No, sir.

Q. If he had fallen into error, that is not your responsibility?

A. I am not responsible for his training, whether he is correct or incorrect.

Q. You mentioned some things you have written. Have you ever written anything on the subject that you have been discussing here this morning?

A. I have not actually written anything, sir, on by-product accounting. I have written on cost accounting.

Q. Not on by-product accounting? [1181]

A. That is correct.

Q. Have you ever written anything in which you took the position that one of a number of products produced in a common plant which requires its own plant equipment and its own labor for the purpose of making it into a commercial

(Testimony of J. Hugh Jackson.)

product, should not be charged with any portion of the overhead of the plant? Did you ever write anything like that?

A. Let me interpret your statement, sir, or ask you what you mean by your term "overhead." I have already said that you would charge the portion of the overhead which is directly allocable to that particular product. But what I was speaking of was in the case of a by-product, where you have certain broad, general overhead—we will say in this particular instance a New York office, in which the expense of the New York office would go on just exactly the same whether the by-product was processed or not—I do not believe that that kind of overhead should be charged to the by-product.

Q. How about the plant superintendent who devotes his time to the production of the so-called by-product, as well as other products of the plant?

A. If the plant superintendent or any other portion of the expense of the plant would go on just the same without the byproduct being there, then I believe most businessmen—and I base this, sir, upon my studies of probably 50 corporations which I have visited in the last two or three years over the [1182] country, as to their practices and procedures—most of them would not include that as part of the cost of the by-product.

Q. So if I understand you correctly, your philosophy is any expense that would continue, even though you discontinued the production of the so-called by-product, should not be included in the cost, is that your philosophy?

(Testimony of J. Hugh Jackson.)

A. That would be my general philosophy, yes, sir.

Q. On what rational basis, Professor, do you distinguish between a by-product and a co-product in arriving at that result?

A. Well, as a good many other people I have heard testify said, it is more or less on an arbitrary basis. You cannot absolutely determine. In a general way, a by-product is a product which is incidental to the manufacture of a main product. You might have two products, both of which were so important that they would be joint products or co-products, because neither one of them takes much precedence over the other. But you might have a number of small products or incidental products which would come off, and which the business would have to determine whether or not, if I may use the figurative expression, they would let the material wash down the sewer or whether they would process it still further, and if they are going to process it still further, then I think that product has got to stand on its own feet and be charged only with the additional expense which would be incurred in the processing of it. [1183]

Q. But as far as superintendence which that particular plant requires, the same as any other product——

A. If you had a separate superintendent or a separate foreman for that particular department, that would be part of your direct overhead.

(Testimony of J. Hugh Jackson.)

Q. But if it is more practical and economical to handle it, we will say, through a general plant superintendent who devotes a portion of his time to the plant in which this so-called by-product is produced, the same as the other products, you would say that it would be improper accounting to allocate a portion of that supervision to the by-product merely because you cannot directly determine the amount of time the superintendent has devoted to the by-product? Is that what I understand?

A. I believe that is true, yes, sir.

Q. Where do you distinguish between a by-product and a co-product? Where is the line of demarcation?

A. As I said a moment ago, sir, that is more or less of an arbitrary matter. Some people take the attitude a product of a certain percentage of value—in other words, if a product is less than, we will say, for the sake of illustration, 10 per cent of the total value, it would be considered a by-product. If it is more than that it might be considered a co-product. I am not saying that is the point of demarcation, but I am saying there is more or less of an arbitrary basis in making that decision. [1184]

Q. At least on that arbitrary basis, if the value of the co-product is 10 per cent or more of the value of the so-called main product, then you would treat it as a co-product for accounting purposes, would you?

(Testimony of J. Hugh Jackson.)

A. I am using 10 per cent just as an arbitrary illustration. If you use that as an arbitrary division point, the answer would be yes.

Q. Didn't you say that that is the position that some people take?

A. No, I said sometimes that is taken.

Q. At least under that theory, if the value of the so-called by-product was 10 per cent or more of the value of the other product, you would treat it under that theory, at least, for accounting purposes, as a co-product, wouldn't you?

A. If I were treating joint products or co-products, both terms being used more or less synonymously, then, of course, you would make your allocation of overhead, general overhead as well as direct overhead, to both products.

Q. Let me ask you, Professor, you have been a member of the NACA since when?

A. Since November, 1919.

Q. Did you take part in that inquiry they had back in July, 1920, or August, 1920, on the subject of by-product accounting? A. No, sir.

Q. Have you ever read it? [1185]

A. Yes, sir, I have read it. I am sure I read it at the time, because I was teaching cost accounting at Harvard at the time, and I have read it more recently, also.

Q. Isn't it a fact at that time the majority of the members of that institute said they favored complete costing of by-products which require proc-

(Testimony of J. Hugh Jackson.)

essing in order to make them salable? Isn't that true?

A. In so far as it is possible to do so without too arbitrary an allocation, but I do not believe, sir, that it stated that general overhead expense of the kind that we are talking about should be charged against the by-product.

Q. Let me ask you this, Professor: Accounting is supposed to be a rational science, isn't it?

A. It is supposed to be good common sense.

Q. It is supposed to be good common sense?

A. That is right.

Q. If you have a plant that is making ten products, and I will let you put them all in the category of co-products, it is perfectly proper under those circumstances to allocate plant overhead of the kind you and I have been talking about among the ten products, isn't it?

A. Well, if you had ten co-products—I could not conceive of ten co-products.

Q. Let us get down to four.

A. If you had two or three, we will say, that were major co-products, [1186] then on some arbitrary basis or other you would make the allocation, yourself.

Q. Let us make it four. Now, if you are making four co-products you allocate the plant overhead among those four products, don't you?

A. That would be correct.

Q. That would be good accounting practice?

A. I think that would be.

(Testimony of J. Hugh Jackson.)

Q. The fact remains if you discontinued one, the overhead would continue just the same, but in some lesser amount?

A. It might continue in some lesser amount; it might not.

Q. You can answer that just as accurately as you can answer the question if one of those products was, as you term, a by-product, whether the overhead would continue as to that by-product: You do not have any dispute there, do you?

A. The difference, however, sir, is in the case of co-products, the co-products are all co-products in your general scheme of manufacturing, whereas your by-product is a purely incidental thing.

Q. You mean you can't help it?

A. That is right. It can be waste or not, and you have to make the decision afterwards as to whether or not you continue to produce them, whether you go ahead and make that by-product a salable product, or not.

Q. Of course, you do not know whether the product we are talking [1187] about in this case is a by-product, do you?

A. I do not know very much about the particular case, sir. I am talking only in general principles.

Q. In other words, you are just assuming a typical by-product, aren't you?

A. That is correct.

Q. And, of course, in the case of a typical by-product, the amount of by-product that you get depends and is incidental to the amount of main product you produce, isn't it?

(Testimony of J. Hugh Jackson.)

A. It comes off as a natural result of the production of your main product at a split-off point. The decision has to be made there as to whether you will proceed to process it further or not.

Q. What I say is true, isn't it, that the amount of by-product that you get, the by-product material, depends upon the amount of the main product that you produce, isn't that true?

A. Yes, at the split-off point.

Q. And if you found that you were producing in the plant the maximum of product A and you were not producing the maximum of product B, you would not call product A a by-product of product B, would you?

A. You mean in the hypothetical question that was asked?

Q. Yes.

A. Well, I think the assumption was made there that product A was your main product. [1188]

Q. Forget that hypothesis. Let us start with a new one. You have a chemical plant where you are using a common raw material, and you take out a chemical element A. You process that and make a finished product, and then the raw material goes on and you process that and you make a product B, and if you found out that in this plant you were making the maximum of product A that could be taken out of the raw material, but you were not making the maximum of product B, you certainly would not say that product A was a by-product of product B, would you?

(Testimony of J. Hugh Jackson.)

A. No, I do not think you ordinarily would.

Q. You said you heard there was no charge made in this case prior to the point of separation. Where did you get that information?

A. I am sorry if I said that. I did not realize I said it in this case. I said I thought that was the general rule with reference to the split-off point for by-products, that no charge was made at the split-off point for the by-product.

Q. You were not purporting to speak subjectively as to this case, then?

A. I know nothing about this particular instance.

Q. When were you first contacted about testifying in this case?

A. Do you want me to tell exactly what the situation was?

Q. No, I am just asking you approximately when the plaintiff first contacted you.

Mr. Bennett: I would be willing to let him state what [1189] the situation was.

Mr. Rosenberg: Mr. Bennett, I did not bother you on direct. Leave me alone for a minute.

The Witness: I am contacted——

Q. (By Mr. Rosenberg): Just when, Doctor?

A. Let me think. I am not absolutely sure about it, whether it was—let's see. This is Friday. About Thursday or Friday of last week. One afternoon I was called on the telephone, and in the evening of the same day, sir, you called me.

(Testimony of J. Hugh Jackson.)

Q. You already had been contacted and were available for testimony at that time, weren't you?

A. That is correct.

Q. That is just what I wanted to develop.

Mr. Bennett: I did not like that last statement of yours. I think it was an unfair left-hand dig at the witness that is going to force me to ask him more questions about that, Counsel. I assume you imply this witness is willing to sell himself.

Mr. Rosenberg: No, I did not mean that, at all.

The Court: I just informed myself from the witness, while you gentlemen were quarreling, that he did not consider anything that has occurred a dig, at all.

Mr. Rosenberg: I can assure the witness, your Honor, I did not mean to imply the thing Mr. Bennett thought I did. If I gave that impression, Professor, I want to apologize.

The Witness: I stated to Mr. Rosenberg I felt an expert [1190] witness' testimony would be approximately the same whichever side he testified for. Isn't that what I stated to you over the phone?

Mr. Rosenberg: Yes.

The Witness: In other words, I would tell the truth as I saw it with reference to the scientific aspects of the subject.

Q. (By Mr. Rosenberg): Will you tell me, Doctor, can you refer me to any authority that you have come in contact with in your capacity at Stanford University that you consider authoritative, in which it is stated that where you have product

(Testimony of J. Hugh Jackson.)

that is designated as a by-product, which requires physical plant and direct labor to make it a salable, merchantable product, that it is improper in determining the cost of production of that product to include anything other than direct labor and material cost. Can you refer me to any authority?

A. No, sir. Now, wait a minute.

Q. All right. I will go ahead with you. And overhead expense that is directly allocable to that product.

A. Yes, all additional overhead that would be incurred specifically for that product.

Q. You do not have to allocate that, do you?

A. No. Well, you might do so on a tonnage basis, or some such thing as that.

Q. You mean to determine unit cost?

A. Yes, unit cost. [1191]

Q. But as far as the aggregate production of the product is concerned, there is no allocation problem involved, is there?

A. That is correct.

Q. What I am asking you to tell me is if you can refer me to any authority in which it is stated that because you designate a product as a by-product, and it being a product which requires a physical plant and direct labor to make it into a merchantable product, it is improper to allocate any overhead expense to that product: Can you refer me to any authority on that?

A. I do not know, sir, that I could quote at the moment any one of the authorities on cost account-

(Testimony of J. Hugh Jackson.)

ing that specifically state that. I think, however, sir, there are statements of that kind appearing in cost literature, but I could not name the specific——

Q. Didn't Mr. Bennett ask you? He implied to the court that that was the purpose for which he brought you here. Didn't he tell you to come with any authority you had to sustain your position?

A. No, not with reference to——

Q. Have you ever heard of Cannan?

A. I know Eric Cannan very well. He is a good friend of mine.

Q. He is recognized as a good cost accountant?

A. Yes.

Q. Have you ever read his book? [1192]

A. Yes, sir.

Q. Doesn't Mr. Cannan say that to take a product which comes out of a plant and which requires a physical plant and requires labor, to apply the term "by-product" to that and treat it as a by-product results in superficial accounting? Isn't that what he says?

A. I couldn't answer your question, sir.

Q. Maybe I can help you. Just read that paragraph.

A. I do not see anything in that statement, sir, which would say that he feels that the elimination of broad general overhead would be an incorrect basis of accounting.

Q. Wouldn't you construe this to be an expression of his opinion that you treat a by-product the same as a co-product?

(Testimony of J. Hugh Jackson.)

A. He says it sometimes leads to superficial accounting if you do not do that.

Q. What do you think he meant when he said this, Professor:

“The word ‘by-product’ is a troublesome thing. Frequently by-products are of considerable value. They may even be worth more than the so-called main products from which they derive. The implication in the word ‘by-product’ that a by-product is merely nominal because it is incidental to the obtainment of some other may lead to superficial accounting treatment? Such products are better regarded as joint products, differing, it is true, in importance and value as well as nature, but nevertheless [1193] meriting equal consideration as products.”

Don't you construe that to mean that they should be treated in the same manner as you treat co-products?

A. Let me say this to you: If the statement there which he makes that the by-product is worth more or might be worth more than the main product is true, then it would cease to be a by-product.

Q. You will concede, Professor, when a man is talking about by-products, a man such as Mr. Cannan, he knows what he is talking about?

A. I would say he knows as much about it as the ordinary cost accountant.

Q. Maybe a little more than the average?

A. He is recognized as one of the authorities, of course.

(Testimony of J. Hugh Jackson.)

Q. So when he says, "Such products (and he is talking about by-products) are better regarded as joint products, differing, it is true, in importance and value as well as nature, but nevertheless meriting equal consideration as products," don't you construe that to mean that it is Mr. Cannan's opinion a by-product should be treated for accounting purposes in the same manner as you would treat a co-product?

A. I would think that is what Mr. Cannan means, where you have a by-product, but that would not necessarily mean all authorities would agree with him on that.

Q. I do not say that. [1194] A. Yes.

Q. Getting back to this publication by the NACA, you recall that this paper speaks of three different methods of by-products accounting; do you recall that? A. Yes, sir.

Q. And the last method is what they call the total cost method, is that right? Do you recall that?

A. Yes.

Q. And under the third method there it speaks of an equitable—what does it say?

A. An equitable proportion of overhead.

Q. Naturally that means an allocative portion of overhead, doesn't it?

A. I would not necessarily think so, sir.

Q. What would an equitable portion be? If it were direct overhead of a separate plant devoted to the by-product it would not be an equitable proportion, would it? It would be overhead?

(Testimony of J. Hugh Jackson.)

A. I think it might be.

Q. You think it would?

A. I think it might very definitely be.

Q. What do you construe this to be, an equitable portion, if it was allocated? What do you think that means?

A. I think that means, sir—and perhaps I do not go as strongly on that as some people because two out of the three men who [1195] constitute that department are former students of mine—

Q. Can you say that?

A. Two out of the three men who operate the research department of the NACA are former students of mine.

Q. And they were back in 1920, were they?

A. I could not be sure about that. I know not both of them, because one of them has graduated since. One of them went from Harvard at that time. But I think when they simply say an equitable proportion of overhead they mean a proportion of overhead that would be recognized on the basis of what we would commonly call allocating to a joint product or a by-product, and that does not necessarily mean at all, sir, that you are going to put this general overhead on the by-product.

Q. But, Professor, you spoke of allocating general overhead to a by-product. I thought that was

(Testimony of J. Hugh Jackson.)

never done. A. I said I would not do it.

Q. But you will concede that there is reputable authority that feels that is proper?

A. I think that some writers would say yes, surely. You had a witness on the stand who said that.

Q. Let us not confine it to such small numbers. You would go a little further than that, wouldn't you? There is a school of thought in accounting that feels that where a product gets out of the category of waste or scrap, for accounting purposes it is proper to treat it the same as you do a co-product, isn't [1196] that true?

A. I think there are some who would say that, yes. But I still say that the general—in my opinion, at least, the best accountants and those who are thinkers on this subject would say that the overhead which would continue on should not be allocated to the by-product.

Q. Then that school of thought are not in favor of anything but direct charges, are they?

A. That is correct.

Q. There is a school of thought that do not even cost account by-products, isn't that true? As a matter of convenience and expediency it is very common practice not even to cost account by-products, isn't it?

A. I suppose you would say that. You mean by that those who simply sell the by-products for what

(Testimony of J. Hugh Jackson.)

they can get for them and credit the selling price to the main product?

Q. That is very common?

A. Yes, that is very common procedure.

Q. But it does not result in determination of cost, does it?

A. No, that does not necessarily mean, and it usually does not mean that.

Q. The reason you do that, in the last analysis, is that it is an expedient thing to do?

A. The same reason for which we use the straight line depreciation so frequently. [1197]

Q. It is an expedient thing to do?

A. An expedient thing to do.

Q. Have you ever read Neuner on Cost Accounting?

A. I have a copy of it. I have read some sections out of it. I have not read the whole volume, no.

Q. Have you read the chapter that deals with by-products accounting?

A. I do not think I have.

Q. So you are not familiar with that?

A. I do not think I am familiar with that particular chapter. There are so many of these books coming out all the time you can't read all of them.

Q. That is part of your function as dean of the business school down there, to keep abreast of these things?

A. That is one of my small parts of my function.

Q. How long is it since you set up cost accounting for any concern?

(Testimony of J. Hugh Jackson.)

Mr. Bennett: You mean actually in profession?

Q. (Mr. Rosenberg): Professionally.

A. Well, of course, my work has not been so much, sir, of going in and actually setting up a cost accounting system as advising the existing people with reference to their cost accounting system, and I am doing that more or less constantly all the time, sir. I do not think I should necessarily name specific people that I have done that for, or anything of that kind. [1198]

Q. No. You say you are familiar with this book by Neuner, are you?

A. I have a copy of it on my shelf.

Q. Who is Neuner? Is he anyone of any authority?

A. I could not answer your question at the moment. I forget the organization he is associated with. I do not happen to know him personally, at all.

Q. At least you will concede it is not uncommon, is it, Professor, to record the cost of a by-product before and after separation from the main product and to treat it for accounting purposes the same as a co-product?

Mr. Bennett: Why go into that? You people treated this yourself in such a way that you do not charge processing prior to the point of separation.

Mr. Rosenberg: That is about the fifth time Mr. Bennett has said that and there is not a particle of evidence in this record that there is any cost prior to the point of separation.

(Testimony of J. Hugh Jackson.)

Mr. Bennett: There is cost.

Mr. Rosenberg: What is it?

Mr. Bennett: You would be charging the cost from the time you get the bittern.

Mr. Rosenberg: We do.

Mr. Bennett: No, you do not.

Mr. Rosenberg: We do not? [1199]

Mr. Bennett: You stated here in your opening statement, and your witnesses have, up to the point of separation of the calcium sulphate you charge no processing charges against gypsum.

Mr. Rosenberg: Because there is no processing charge.

Mr. Bennett: There is the handling of the fluid in the holding ponds, pumping into settling tanks.

Mr. Rosenberg: Oh, no. You recall Mr. Watt's testimony. That is one of the reasons the bittern charge went up one time, because the cost of the pumping of bittern went up, and we are charging it with the raw material.

Mr. Bennett: He said he made an arbitrary charge, but you, yourself, stated there was no processing charge up to the point of separation.

Mr. Rosenberg: Maybe that was the one instance I made a mistake in this case. No further questions.

Mr. Bennett: That is all. Thank you, Professor. Your Honor, I have one lone witness.

The Court: Call him.

WILLIAM R. KLECKNER,

called as a witness on behalf of Plaintiff in Rebuttal; sworn

Q. (The Clerk): Your name?

A. William R. Kleckner.

Direct Examination

Q. (Mr. Bennett): Will you state your present occupation, [1200] Mr. Kleckner?

A. I am chief chemist of the Cement Division of the Pacific Portland Cement Company.

Q. How long have you been such?

A. I have been in that position during the past five or six years.

The Court: May I inquire, for the purpose of the record, what is the purpose of this testimony?

Mr. Bennett: To show by this witness—and I can show by one or two questions after I have finished his qualifications—this sulphuric acid, which your Honor recalls during the last period was suddenly added to the cost of gypsum, and which had never been charged before, is not used solely for the production of gypsum, but its main purpose is for the production of magnesium oxide, and therefore it is not proper to include sulphuric acid as a charge against gypsum.

The Court: How many questions did you say?

Mr. Bennett: I think three questions after he finishes his qualifications. I will try to hold myself to that magic three.

The Court: I have tried diligently, with all the energy I have had, to minimize in some fashion

(Testimony of William R. Kleckner.)

our prolonged hearing here, but I have failed, and now that we have gone thus far, if you have only three questions I will yield.

Q. (Mr. Bennett): State your education and training as a [1201] chemist, Mr. Kleckner?

A. I graduated from a chemical course in 1904 at Muhlerberg College, Pennsylvania, and took a one-year course in metallurgy and assaying at Lehigh University, Bethlehem, Pennsylvania, and two years later I became chief chemist of the Heikle Cement Plant at Bay City, Michigan, and since then I have been employed almost continuously as either a consultant chief chemist or directing chief chemist of cement plants in California, and I have been called as a consultant on iodine plants, and I have also prepared processes; at least one distinctive process for the War Department in February of 1942 for the manufacture of magnesia as well as a continuation with the magnesia extracts to the point of making metallic magnesia which was approved by the War Department and their board of consulting chemists. [1202]

Q. Have you made any study or experiments with reference to the production of magnesium oxide and gypsum from bittern in any way in which the use of sulphuric acid has been employed?

A. Yes.

Q. Have you made specific laboratory tests on those?

A. I have.

Q. As a result of those tests and your training and experience, I ask you, if in your opinion

(Testimony of William R. Kleckner.)

whether or not in the manufacture of magnesium oxide as a primary product and where it is at the stage shown on this chart, Plaintiff's Exhibit 16 for identification, calcium sulphate is precipitated off or taken off, whether the addition of sulphuric acid prior to the separation of the sulphate from the bittern water furthers the manufacture and recovery of the magnesium oxide.

A. Yes, it does.

Q. In your experience and as a result of your knowledge and experience, would you say in the addition of sulphuric acid prior to any taking off of the calcium sulphate, whether the purpose of that sulphuric acid is for the efficient processing or taking off of magnesium oxide——

A. For the magnesium oxide?

Q. Does the addition of the sulphuric acid affect in any noticeable or material way either the precipitation or formation of gypsum crystals?

A. No, it does not. [1203]

Mr. Bennett: You may cross-examine.

Cross-Examination

Q. (Mr. Rosenberg): When did you conduct these tests, Mr. Kleckner?

A. I have conducted tests on sea water and the constituents contained in sea water over a period of years. In our Redwood City plant we are very much concerned about sea water for the reason that we use hundreds of thousands of gallons of sea water every day and we also have in one of our recovery departments considerable salts derived from sea

(Testimony of William R. Kleckner.)

water. These naturally have been the object of my attention for the purpose of recovering them in a commercial way and to put them on the market and sell them for a price that would net the company some extra values.

Q. Are you familiar with the Permanente Company plant at Moss Landing? A. Yes.

Q. They recover magnesium oxide there, don't they? A. Yes.

Q. Do they use sulphuric acid?

A. That is more than I can say. I don't know whether they do.

Q. Don't you know for a fact they do not?

A. As a matter of fact, the reason I so state was that I made no definite inquiries at the Moss Landing plant as to whether or not they did or did not. [1204]

Q. Have you been down there?

A. Yes, I have been through there.

Q. Have you inspected their processes?

A. Well, yes.

Q. But you didn't find out whether they were using sulphuric acid? A. No.

Q. When you conducted these tests or experiments that you have mentioned, was it determined that sulphuric acid is essential to the production of magnesium oxide?

A. Those tests and determinations were made over a period of a number of years and again I repeated, during the last few months, to check up very definitely upon the propriety of adding sul-

(Testimony of William R. Kleckner.)

phuric acid or omitting it in the preparation of the magnesium hydroxide precipitate.

Q. Where was the test conducted? In the laboratory?

A. The test was conducted partly at Redwood and partly at the San Juan cement plant.

Q. But not in a plant in the actual production of gypsum? A. No.

Q. You don't have any facilities at that plant for gypsum, do you?

A. No, we are not manufacturing gypsum on a commercial basis.

Q. Did you make any tests without adding sulphuric acid and precipitating the calcium sulphate? [1205] A. Certainly.

Q. You say that the crystals were identical to those that you precipitate when you use sulphuric acid? A. Correct.

Q. No difference in size or shape?

A. The gypsum crystal is monoclinic and it is true that no precipitation of chemical substance—they will have a certain gradation of large, medium and small crystals depending on the rate of crystallization.

Q. Well,—

A. But on comparative studies on the same bittern using sulphuric acid in one case, and leaving it out in another case, in the precipitation of the gypsum, the crystals were all the same size and all of the monoclinical type.

Q. You had no opportunity to run them through

(Testimony of William R. Kleckner.)

a commercial filter plant to see if they would react differently in a filter plant?

A. No, naturally not.

Mr. Rosenberg: That's all.

Redirect Examination

Q. (Mr. Bennett): They don't manufacture any magnesia products at the Permanente plant at Moss Landing out of bittern, do they?

A. No, they manufacture magnesia out of sea water.

Q. Would there be a different effect on the purpose and use of [1206] sulphuric acid in the case of bittern than there would be in sea water?

A. Yes, if you propose to manufacture magnesia hydroxide out of bittern.

Q. Why does it have the effect you say it does on magnesia, Mr. Kleckner?

A. The distinction must be kept in mind that at Moss Landing they are drawing their raw material which is ocean water directly from the ocean; whereas bittern is a very complicated or complex solution consisting of the contamination of a great number of things resulting from the evaporation of sea water and includes both the chemical constituents that are derived from algae as well as decayed matter and sewage that is naturally dumped into the lower end of the Bay. Now, the sulphuric acid addition will counteract the colloids and the mucilaginous materials derived from the algae and will produce a magnesium oxide precipitate that will be highly dispersed, settle very slowly and go

(Testimony of William R. Kleckner.)

into a colloidal or gelatinous state very rapidly. But with the addition of the sulphuric acid to the bittern, a remarkable change takes place in that the magnesium oxide becomes a crystallant rhomborhedral, tabular crystals would settle fast and are of high purity; in fact, maximum purity.

Q. You wouldn't get that condition so far as the magnesium oxide is concerned unless you would use the sulphuric or some other acid? [1207]

A. That's right.

Mr. Bennett: That's all.

Recross-Examination

Q. (Mr. Rosenberg): In the tests or experiments that you made, did you use bittern?

A. Yes.

Redirect Examination

Q. (Mr. Bennett): Where did you get the bittern?

A. I got the bittern out of one of the Westvaco storage tanks.

Mr. Rosenberg: I am glad you brought that out, Mr. Bennett.

The Court: Step down.

Mr. Rosenberg: I have just one other question, Your Honor.

The Court: Very well.

Recross-Examination

Q. (Mr. Rosenberg): What is the function that sulphuric acid plays in the production of magnesium oxide? Would you explain that, because I did not understand it.

(Testimony of William R. Kleckner.)

Mr. Bennett: He already answered that. He gave his answer.

Mr. Rosenberg: I believe you are right.

The Witness: But in addition to that, it does produce the albuminoids from the amino-acids.

Mr. Bennett: I am about to close and I ask at this time that the following portions of the defendant's answers to the [1208] plaintiff's interrogatories which are on file, be admitted in evidence and deemed read and the Reporter can include in his record. I don't think Your Honor needs to have them read now. We will ask they be admitted and deemed read.

Mr. Rosenberg: I am going to object to anything being read into the record at this time. This is not proper rebuttal. I don't know what counsel is talking about, but I submit at this time it is highly improper to ask that anything be admitted in evidence that is not strictly rebuttal evidence.

Mr. Bennett: How could the defendants be hurt by any admissions they have made?

The Court: Those are matters of record, are they not?

Mr. Rosenberg: I don't think they are matters of record. I think they are in the same category as depositions. They may or may not be used.

The Court: What I had in mind was this: I think I tried to indicate that I permitted abuses that I had no question in my mind about in relation to the trial of this case. However, in the first place, I was going into a strange field and I allowed the widest latitude for that reason. But to come

along now at this hour and at this time dig up the record here in relation to the subject matter therein contained and offered without opportunity of the other side meeting it——

Mr. Bennett: If I may interrupt, Your Honor, how can there be any possible prejudice? All I am offering is what they have [1209] admitted in their interrogatories. As I have told Your Honor before, and I say this respectfully, the burden of proof rests on the defendant after we have shown the controversy, because they have the affirmative of showing the propriety of the price increase.

The Court: I am not prepared to say that. You may deal with that phase of the matter in your brief. I say that so you will have the benefit of my state of mind.

Mr. Bennett: Your Honor, I can not conceive of where at this juncture there could be any claim of any conceivable prejudice. All we want to offer at this time, in addition to this chart which has been identified and referred to in the evidence by a number of witnesses, are certain of these admissions that the defendants have made in their interrogatories. Obviously no prejudice can come from that. They know what they said, and they probably took plenty of time, too. The evidence shows Mr. Watt collaborated in those answers——

The Court: Both of you did much in the way of collaboration. I hold you both equally guilty on that score. Do you insist upon your objection?

Mr. Rosenberg: Yes, Your Honor. I say the interrogatories are in the same category as the

depositions. If the occasion arises during the course of the trial to use depositions, it is perfectly proper, and it can be done at the proper time. It is true that I am perfectly willing to be bound by anything in our [1210] answers except where it may develop through testimony introduced here that someone else knew more about the subject than the attorney or accountant who collaborated in getting out those answers.

The Court: I am prepared to indicate to you that you can get together, if you can, so both sides may have full and equal opportunity.

Mr. Bennett: The only thing is, we want to refer to certain admissions that the defendants made in their interrogatories, in preparing our brief.

Mr. Rosenberg: I think that about demonstrates the basis of the objection. Here they have finished their case in chief and their rebuttal testimony and now when the case is all over they want to bind us to some admissions. I don't know what they are. Maybe they are responsive to questions, but maybe they are not completely responsive.

The Court: Gentlemen, I am prepared to rule now.

Mr. Bennett: Don't you think, Your Honor, I should make it clear what I have offered?

The Court: You may.

Mr. Bennett: I have already indicated, or intended to indicate, Exhibit D; also the answers in No. 9G, the answers in No. 10G.

The Court: I will adjourn this case until 2:30 this afternoon so both sides may get together on this and indicate what you wish to do.

(Whereupon an adjournment was taken until 2:30 p.m.) [1211]

Friday, January 2, 1948, 2:00 o'clock p.m.

Mr. Rosenberg: If our Honor please, when we adjourned we were discussing the answers to the interrogatories. As I stated at that time, I do not think that they are admissible as evidence in rebuttal. However, I have no objection to them going in except to state that I would expect that they would be considered in the light of the testimony that may have gone into the record on specific subjects. I do not know whether there is anything inconsistent with those answers and the testimony that may have gone into the record. The evidence shows they were prepared by me with the assistance of Mr. Watt. Some of them dealt with some subjects where some of the technical testimony was slightly different. I do not know that to be the case, but I would have no objection to them being considered under those circumstances.

Mr. Bennett: Your Honor, so the record will be clear, I will offer at this time as admissions and for the purpose of showing contentions made by the defendant, the following interrogatories by the plaintiff and the answers thereto as appears from the interrogatories and answers on file with the Court, and ask that the same be deemed read and the Reporter may write them into the transcript.

No. 6G, Exhibit C; No. 9G; No. 10G; No. 11; No. 19; No. 20. There are other answers and interrogatories that I think [1212] have already been admitted in addition to those, Your Honor.

(The interrogatories and answers referred to are as follows:)

“6(G). State in what particulars and to what extent each element of such cost as determined by defendant for each of said periods ended June 30, 1940, and June 30, 1941, respectively, contributed to or was related to the production of gypsum. State whether each element would have been incurred if no gypsum had been produced.

“Answer: See Exhibit ‘C’ attached hereto. None of the direct charges shown on Exhibit C would have been incurred if no gypsum had been produced. Indirect charges shown on Exhibit C would have been incurred if no gypsum had been produced but in lesser and unascertainable amounts.

	July 1, 1940 June 30, 1941	July 1, 1939 June 30, 1940	
(a)	\$1.84	\$1.66	
(b) Labor—Operations	.19	.19	Actual time card dist.
Labor—Repairs	.13	.11	Actual time card dist.
Comp. Ins. & S.S. Taxes	.02	.02	Follows labor
Materials—Operations	.02	.01	S'room req. & Direct purch.
Materials—Repairs	.21	.10	S'room req. & Direct purch.
Bittern (1)	.14	.10	Arbitrary allocation
Water	.01	.04	At cost—measured
Power	.13	.11	At cost—measured
Gas	.09	.11	At cost—measured
Fuel Oil	.00	.00	At cost—measured
Overhead (2)	.35	.29	Allocated—Labor
Taxes, Ins. & Depre.(3)	.38	.37	Allocated—% roughly based on plant value
Interdept. Charges	.00	.01	At cost
Ship. Expense (4)	.18	.19	Actual cost plus pro-rate of Misc. Ship. Exp.
(c) (1) Gypsum	.14	.10	per ton

	July 1, 1940	July 1, 1939
	June 30, 1941	June 30, 1940
Bromine	25.40	17.80 per ton
Magnesia	.67	.52 per ton
(2) Gypsum	7.2%	7.1%
Service Accounts	3.0%	3.9%
Lime	9.5%	12.6%
EthyleneDibromide	23.9%	28.8%
Magnesia	56.4%	47.6%
(3) Gypsum	7.6%	7.4%
Service Accounts	3.0%	2.9%
Lime	30.4%	31.0%
EthyleneDibromide	21.3%	23.8%
Magnesia	37.7%	34.9%
(4) Gypsum	6.0%	8.9%
EthyleneDibromide	18.2%	19.0%
Lime	3.6%	9.7%
Magnesia	72.2%	62.4%

“Interrogatory No. 9(G). State the facts called for interrogatory 6(F) as incorporated in this interrogatory 9, if defendant’s cost per ton of production of gypsum as calculated by defendant for the 12-month period ended December 31, 1943, contained any element of cost not included in such cost as determined for the 12-month period ended December 31, 1942, or for either of the aforesaid periods ended June 30, 1940, and June 30, 1941, respectively; or if such costs as calculated by defendant for the twelve-month period ended December 31, 1942, contained any element of cost not included in such cost as determined for either of the aforesaid periods ended June 30, 1940, and June 30, 1941, respectively”;

“Answer 9(G). See Exhibit ‘E’ attached hereto. None of the direct charges shown on Exhibit E

would have been incurred if no gypsum had been produced. Indirect charges shown on Exhibit E would have been incurred if no gypsum had been produced but in lesser and unascertainable amounts.

EXHIBIT E

	Year	Year	
	1943	1942	
(a)	\$2.71	\$1.93	
(b) Labor—Operations	.39	.26	Actual time card dist.
Labor—Repairs	.16	.12	Actual time card dist.
Comp. Ins. & S.S. Taxes	.03	.02	Follows Labor
Materials—Operations	.02	....	S'room req. & Direct Purch.
Materials—Repairs	.07	.06	S'room req. & Direct Purch.
Bittern (1)	.20	.20	Arbitrary Allocation
Water	.01	....	At cost—measured
Power	.18	.15	At cost—measured
Fuel	.14	.10	At cost—measured
Overhead (2)	.82	.42	Allocated—Labor basis
Taxes, Ins. & Depr. (3)	.49	.41	Allocated—% roughly based on plant value
Inter-departmental charges	.01	....	At cost
Ship. Expense (4)	.19	.10	Actual cost plus pro-rate of Misc. Ship. Expense
(c) (1) Gypsum	.20	.20	per ton
Bromine	16.60	15.80	per ton
Magnesia	1.11	.96	per ton
(2) Gypsum	5.3%	5.0%	
Service Accounts	2.7%	2.9%	
Lime	11.6%	7.9%	
Ethylene Dibromide	17.1%	16.3%	
Magnesia	63.3%	67.9%	
(3) Gypsum	8.1%	7.1%	
Service Accounts	2.2%	2.1%	
Lime	25.2%	23.3%	
Ethylene Dibromide	11.2%	18.7%	
Magnesia	53.3%	48.8%	

(4) Gypsum	3.7%	6.2%
Lime	11.1%	14.7%
Ethylene Dibromide	4.6%	4.8%
Magnesia	30.6%	71.3%

“Interrogatory 10(G). State the facts called for by interrogatory 6(F) as incorporated in this interrogatory 10 if defendant’s cost per ton of production of gypsum as calculated by defendant for the twelve-month period ended June 30, 1946, contained any element of cost not included in such cost as determined for the 12-month period ended June 30, 1945, or for either of the aforesaid periods ended December 31, 1942, and December 31, 1943, respectively; or if such cost as calculated by defendant for the twelve-month period ended June 30, 1945, contained any element of cost not included in such cost as determined for either of the aforesaid periods ended December 31, 1942, and December 31, 1943, respectively.”

“Answer 10(G). See Exhibit ‘F’ attached hereto. None of the direct charges shown on Exhibit F would have been incurred if no gypsum had been produced. Indirect charges shown on Exhibit F would have been incurred if no gypsum had been produced, but in lesser and unascertainable amounts.”

EXHIBIT F

		July 1, 1944	July 1, 1945
		June 30, 1945	June 30, 1946
(a)		\$2.52	\$3.24
(b)	Supervision (5)	.04	.04 Allocated
	Labor-Operations	.32	.35 Actual time card dist.
	Labor-Repairs	.21	.25 Actual time card dist.

Materials-Operations	.02	.05	S'room req. & Direct Purch.
Materials-Repairs	.11	.20	S'room req. & Direct Purch.
Bittern (1)	.18	.16	Arbitrary Allocation
Water	.02	.02	At cost—measured
Power	.14	.14	At cost—measured
Gas	.10	.11	At cost—measured
Fuel Oil	....	.01	At cost—measured
Sulphuric Acid	....	.35	At cost—measured
Overhead (2)	.74	.38	Allocated—labor basis
Taxes, Ins., Depr. (3)	.42	.39	Allocated—% roughly based on Plant value
Inter-depart- mental charges	.01	.01	At cost
Ship. Expense (4)	.21	.28	Actual cost plus pro-rate Misc. Ship. Exp.
(c) (1) Gypsum	.18	.16	per ton
Bromine	12.75	13.29	per ton
Magnesia	.72	.73	per ton
(2) Gypsum	6.3%	7.8%	
Service Accounts	1.9%	3.1%	
Lime	8.9%	9.1%	
Ethylene Dibro- mide	12.3%	6.3%	
Magnesia	70.1%	73.4%	
(3) Gypsum	9.0%	9.6%	
Service Accounts	4.1%	3.6%	
Lime	26.3%	26.8%	
Ethylene Dibro- mide	12.5%	10.1%	
Magnesia	48.1%	49.9%	
(4) Gypsum	24.0%	46.7%	
Ethylene Dibro- mide	4.0%	0.5%	
Lime	6.4%	4.5%	
Magnesia	65.6%	48.3%	
(5) Gypsum	18.8%	26.0%	
Ethylene Dibro- mide	2.3%	1.1%	
Lime	6.3%	6.0%	
Magnesia	72.6%	66.9%	

“Interrogatory 11. State the character and general subject matter of the books and records of defendants and of the entries therein that are claimed by defendant to be of a confidential and secretive nature or trade secrets, as alleged in lines 7 to 12, page 4 of defendant’s answers; and state wherein said books, records and entries are confidential and secretive and wherein they are trade secrets. Identify said books and records with particularity and state in what individual’s custody and at what place they are now kept.

“Answer 11. Answering Interrogatory No. 11, defendant states that the entries which are claimed by defendant to be of a confidential and secretive nature and to constitute trade secrets are the entries showing the bittern royalties paid by defendant to its supplier, Leslie Salt Company, which entries are contained in the general ledger, production ledger, sales ledger and sundry reports derived therefrom. Said entries [1219] with reference to the bittern royalties are deemed to be confidential, secretive and to constitute trade secrets because to make the desired disclosure would involve disclosure of the terms and conditions of a material contract between said supplier and defendant and inspection of said contract and the payments made thereunder would disclose all the products made by defendant, and the quantities sold. Disclosure thereof would require defendant also to reveal detailed information with reference to all products sold by defendant, including the identity and quantity of such products. Likewise,

defendant has bittern contracts with other producers and the disclosure of the terms and conditions of its bittern contract with Leslie Salt Company might jeopardize the present and future relations of defendant with such other producers.

“Likewise, defendant claims that its books, records and entries showing the bases for allocation of shipping expense are likewise confidential and comprise trade secrets for the reason that disclosure of said information would reveal the products sold by defendant and the quantities and selling prices thereof. The general ledger, which contains the entries above referred to are located in defendant’s plant at Newark, California, and are in the custody of Mr. David Watt, the office manager of defendant.” [1220]

“Interrogatory No. 19. State whether or not defendant discontinued the production of ethylene-dibromide in or about October 1945. If such production was discontinued, state what proportion of the total overhead of defendant’s Newark, California, plant (including taxes, insurance, depreciation and indirect costs of water and steam) was charged or allocated to said product and to each other product produced at said plant for each of defendant’s accounting periods during the time when ethylene-dibromide was being produced at this plant; and state the method or manner, including the accounting principles or procedures, of allocating to other products the proportion of total overhead formerly allocated to ethylene-dibromide that was adopted by defendant upon such discontinu-

ance. State what proportion of such total overhead was allocated to each other product produced at the Newark, California plant during the period of the discontinuance of production of ethylene-dibromide to June 30, 1946.

“Answer: Answering Interrogatory No. 19, defendant states that it did discontinue the production of ethylene-dibromide on or about September 16, 1945. During the period that ethylene-dibromide was being produced, overhead was charged thereto in the amounts shown in Exhibits ‘B’, ‘C’, ‘E’ and ‘F’ attached hereto. Upon discontinuance of production of ethylene-dibromide the general overhead formerly charged thereto was allocated among the other products produced by defendant, on an operating [1221] and repair labor basis. As to what proportion of the total overhead formerly charged to ethylene-dibromide was, upon discontinuance of the production thereof, allocated to the various other products produced by defendant at Newark, California, such information is not available because it is not set up on the books of defendant and cannot be computed, because to make such computation would require the actual knowledge of the cost of production of various elements of cost involved in producing a product which was not produced.”

“Interrogatory No. 20. If the cost of sulphuric acid is now charged or allocated in whole or in part by defendant to the cost of production of gypsum, state in what respect the use of sulphuric acid is necessary to or contributes to the production

of gypsum, and state whether, and to what extent, the use of sulphuric acid contributes to the production, or was or is used in the manufacture or production by defendant, of any other product or products produced at defendant's Newark, California plant."

"Answer. Answering Interrogatory No. 20, defendant states that sulphuric acid is necessary in the production of gypsum because the pH of the bittern is too high to permit of proper precipitation of gypsum from the bittern, and thus sulphuric acid is added to the bittern to lower the pH to a point where separation of gypsum from the bittern is possible. A large [1222] proportion of the sulphuric acid added is incorporated in gypsum produced because the sulphate ions in the sulphuric acid precipitate with calcium ions in the bittern to produce gypsum aggregating approximately $\frac{1}{2}$ to 1% of the total gypsum produced. In other words, the sulphuric acid serves a double function, (1) of controlling the basicity of the solution, and (2) of actually adding weight for weight to the gypsum produced. When defendant operates its bromide department, sulphuric acid is added to the bittern prior to the production of gypsum for the purpose of adjusting the pH of the bittern to permit removal of bromine."

Mr. Bennett: I this morning also stated to your Honor I would like to offer this chart, Plaintiff's Exhibit 16 for identification, in evidence in relation to what it shows in the light of the testimony of the witnesses that have referred to it.

Mr. Rosenberg: I would object to it going in evidence, your Honor. I have no objection to it being a part of the record in order to clarify questions we put to the witness.

The Court: Since the record discloses you made reference to this chart, I think it would be well to have it in.

Mr. Rosenberg: All right. I have no objection. I would like the record to show, however, that we do not concur in the accuracy of that. On the contrary, it is our contention that [1223] that is not a complete depiction of the processes that it purports to depict.

The Court: It is a fair statement to make that it is the theory of the plaintiff's case.

Mr. Rosenberg: Well, not even with that qualification because there is one entire process they have not even purported to show on that, and that is the bromine.

Mr. Bennett: Bromine is not being produced at this particular moment as I understand it, and for that reason we omitted the bromine and I do not think that has any particular bearing on this case except in so far as the matter of sulphuric acid was concerned.

The Court: The only thing I had in mind, we referred to the chart during the examination. So there is no question about it, for that limited purpose, let it be admitted and marked.

(The chart referred to, heretofore marked Plaintiff's Exhibit No. 16 for identification, was thereupon received in evidence.)

Mr. Bennett: In connection with that, may we have an understanding that this chart can be withdrawn at some propitious moment when it won't be wrecked by rain, so we can make, as near as can be, a copy on a smaller, reduced scale.

Mr. Rosenberg: Why not have it photographed?

Mr. Bennett: I do not know what process will lend itself [1224] now. I will furnish a copy to counsel, and if there is any question about the propriety or validity of the copy, we can perhaps straighten it out later.

Mr. Rosenberg: Your Honor, I would like to put Mr. Wallace on again for four questions in surrebuttal. It will take about three minutes.

The Court: Very well. Call him. [1225]

Mr. Rosenberg: Incidentally, I notice I have in my hand, if the Court please, Defendant's Exhibit L, which is marked for identification. It was my understanding this was the laboratory report of that experiment that was run in the plant in making gypsum without the use of sulphuric acid. I thought that that went into evidence. I had intended to offer it in evidence.

The Court: Let it be admitted and marked, if there is any question about it, at all.

(The report referred to was thereupon received in evidence and marked Defendant's Exhibit L.)

DEFENDANT'S EXHIBIT L

Westvaco Chlorine Products Corporation

Process Control Division

Newark, California

October 20, 1947

W. K. Wallace, G. M. Stark, H. L. Bradley, C.
M. Cimino.

To: F. Melhase

From: N. R. Dunbar

Subject: Production of Gypsum from Unacidified Bittern.

The gypsum department was operated during the period 10-10-47 to 10-14-47 with unacidified bittern. This test was made to determine whether satisfactory gypsum crystal sizing could be obtained from alkaline bittern and whether the gypsum filter will operate satisfactorily under such conditions. This method of operation would eliminate the acid addition to raw bittern and the resulting saving would be approximately \$1,000.00 per month in sulfuric acid cost as the only acid necessary would be approximately 10 gallons per day added to the filter bowl slurry to prevent the filter cloth blinding with calcium carbonate.

For this test a small pressure tank was installed from which sulfuric acid was lifted to the gypsum slurry mill hopper. A rotometer was used to measure the flow of acid.

Considerable trouble was experienced with the filter operation and it became necessary to change the cloth after only three days of operation on

unacidified bittern. Under normal operating conditions the average life of a filter cloth is approximately 4 months. At the time this test was made the filter cloth had been in service about 2 months.

The net result of using unacidified bittern was a loss of production due to the time lost in changing the filter cloth and to a lowering of filter capacity. During the 4 days of the test, the total gypsum production averaged 86 tons per day. However, the duration of the test was too short to accurately determine the ultimate capacity of the gypsum department when using unacidified bittern.

/s/ NORMAN R. DUNBAR.

NRD:ro

WILLIAM J. WALLACE,

called as a witness by the defendant in surrebuttal, and having been previously duly sworn testified as follows:

Mr. Rosenberg: Q. Mr. Wallace, referring your attention to this Exhibit L, were you in the plant at Newark on October 10, 1947 to October 14, 1947, at which time this experiment was run for the purpose of determining whether or not you could effectively make gypsum without the use of sulphuric acid? A. I was.

Q. Can you state of your own knowledge whether or not the sulphuric acid free bittern which was run through the gypsum department for the purpose of this test was likewise run through the magnesium department? [1226]

A. It was.

(Testimony of William J. Wallace.)

Q. Can you state whether or not magnesium oxide was produced from the bittern that contained no sulphuric acid?

A. Magnesium oxide was produced.

Q. Can you state whether or not the quality of the magnesium oxide was in anywise affected by the absence of sulphuric acid?

Mr. Bennett: I do not know that this witness is qualified, I would not consider him qualified to that extent, and I object to it on that basis.

Mr. Rosenberg: Q. Let me ask you this: Was the magnesium oxide that was produced from the bittern in which no sulphuric acid had been run, sold and used in the same way as the other magnesium oxide produced from bittern containing sulphuric acid? A. It was.

Q. And did you have any objections made to the quality of it? A. None whatever.

Mr. Rosenberg: That is all.

Cross Examination

Mr. Bennett: Q. Do you know to what particular customers this particular magnesium that was produced without the use of sulphuric acid was delivered?

A. Part of the magnesia produced at that time went to Weyerhaeuser, in Seattle.

Q. During this short period of time? [1227]

A. In that short period of time, during those four days, the magnesia produced went to our normal customers, regular customers. We had Peri-

(Testimony of William J. Wallace.)

glase going to Lavino, and we had Lightburn magnesia going north to Weyerhaeuser.

Q. This magnesia that was produced during that time went into your regular stock, did it not?

A. Our regular stock is ground and sacked and shipped out almost continuously as it is produced.

Q. After it goes through the final processes of treatment to make the magnesium oxide it is stored in large containers, isn't it?

A. Well, I would say that the Lightburn production is stored in a tank that holds about 40 tons, and a day's production is 30 tons. So you do not have very large storage for the Lightburn product.

Q. You did not run, yourself, any tests to determine the relative quantity and the relative precipitations, and so forth, of magnesium oxide during the time you were not actually employing the sulphuric acid, did you?

A. Our laboratory ran tests on shift samples. Every eight hours they took a sample.

Q. This report dated October 20, and which is now Defendant's Exhibit L, says nothing at all about the effect on magnesium oxide, whether or not sulphuric acid is used. You are aware of that, aren't you? [1228]

A. Yes, sir.

Mr. Bennett: No further questions.

Mr. Rosenberg: That is all. The defendant rests.
(Defendant rests.)

Mr. Bennett: The plaintiff rests, your Honor.
(Plaintiff rests.)

Mr. Bennett: There is one matter your Honor has spoken of during the trial, and both counsel have spoken of, and that is the matter of correcting errors that may appear in the transcript.

The Court: I do not think either one of you will have any difficulty with the reporter in that matter.

Mr. Bennett: Such system as we arrange mutually will be satisfactory to the Court and we can communicate with the reporter or your secretary as to the corrections in the original?

Mr. Rosenberg: I think Mr. Bennett and I can get together and file something in the nature of a stipulation on the corrections so we do not have to change the actual transcript.

The Court: That is all right. The case is submitted 10, 10 and 5. That will bring us to what date?

The Clerk: January 28th for submission.

The Court: January 28th for submission, gentlemen.

Mr. Bennett: It may be, as your Honor suggested, perhaps your Honor would want oral argument after the briefs are in. If your Honor desires, we will hear from your Honor in that [1229] particular.

The Court: If I call you in for argument it will be because I cannot satisfy my mind in relation to the authorities and the briefs that you submit. Ten, 10 and 5, gentlemen. That will bring us to January 28th. Keep in touch with the clerk after the briefs are filed. Give me an opportunity

to check your briefs, and then if I feel that I need some argument on anything, I will frankly call you back and ask you to clear up any question that may be in my mind.

Mr. Rosenberg: Thank you, your Honor. I think Mr. Bennett and I both feel that we have had our full day in Court. [1230]

Friday, February 27, 1948

OPENING ARGUMENT ON BEHALF OF PLAINTIFF

Mr. Bennett: Your Honor, I am sure both sides appreciate this opportunity to present to the Court an oral argument in this case. It was a rather lengthy trial. The case was quite novel in its issues. Briefs have been filed by both parties, but in an effort to keep lengthy written arguments to a minimum consistent with the issues there are matters that perhaps lend themselves to an oral presentation.

The Court: I quite agree with you. I suppose if I had given the briefs submitted here the attention that they deserve I would do nothing for thirty days. But I attempted to check those cases. The truth is that both sides can simplify this problem by indicating clearly what answers the Court may give the record here.

Mr. Bennett: Yes, your Honor. I think that is in order, and I think perhaps with this time your Honor has given us we may develop matters which, due to the mass of testimony, otherwise might be somewhat obscure.

This is a declaratory relief action in which both parties seek a declaration of their rights and obligations under three of the paragraphs of the contract for the sale of gypsum by the defendant to the plaintiff, which was executed on January 29, 1937, and which contract has been in force since that time and performance by both sides.

Commencing in 1944, some seven years after the contract was [2] executed, a dispute arose between the parties. This dispute primarily centered around the construction and application to be given to paragraph 6 of the contract, the so-called price protection clause. Later a dispute also arose as to other paragraphs, paragraph 5 of the complaint, which provides for the deductions permissible to the plaintiff in case the gypsum falls below a certain standard and allowed tolerance, and paragraph 3 of the contract, which provides for an option of the plaintiff to decline to take over a specified amount of gypsum during any calendar month and during the calendar year.

The first controversy, and the primary controversy, so far as the major issues involved, concerns paragraph 6, the price protection clause. Your Honor will recall that the parties agreed on the price asked by the defendant's predecessor, namely, \$2.80 per ton, and paragraph 6 was inserted to protect, and solely for the purpose of providing some measure of protection to the seller, the defendant, in case the price increases. The dispute concerning that particular paragraph, stated in its utmost simplicity, is whether the defendant is

entitled to increase the contract price based upon the actual expenses and costs of producing this by-product gypsum, the cost that it would entail because of the production of gypsum, the costs which would not be incurred if no gypsum was produced, or whether it may also include any raises that it asserts in its system of [3] accounting for its so-called overhead of doing business, including a portion of its western division headquarters expense and its New York office, costs that the evidence in this case, by written admissions of the defendant in the interrogatories, answers to the interrogatories, admit would go on and be a costly burden to the defendant company, whether or not gypsum was produced, and which, to be allocated, requires, according to the admission of the defendant's witnesses, an arbitrary allocation, presenting, as the evidence has shown your Honor, not only difficulties but impossibilities in determining whether the purported allocation has any direct application to the production of gypsum, and if so, how much. It is the plaintiff's position, and it has been the plaintiff's position consistently from the beginning, that under the contract, and according to its meaning as appears on the face of the contract, the actual increase in the cost of manufacture of gypsum, which is provided for as a base for any price increase during the comparative period of twelve months, means the actual, determinable costs, and does not mean a speculative or conjectural or arbitrary allocation of the general cost of doing business of the defendant's plant or western headquarters and New York office, costs which are in many

instances unable to be shown and have not been shown by the evidence to have any relation to the production of gypsum, and which cannot be determined and which cannot be determined, and which do not constitute actual [4] cost of the production of gypsum.

I think, your Honor, in view of the issues of the case, particularly as pertains to paragraph 6, this price protection clause, the court should consider and I propose in a short period of time to review the factual background because, if it please the court, the defendant in this case has asserted that the contract is uncertain, that this term "cost of production" as a basis for price increase is so uncertain as to render invalid the whole contract. The defendant therefore has charged an uncertainty. With that charge the court is not only permitted but should, of course, inquire into all the facts and circumstances leading up to the execution of the contract, and what I consider most important, your Honor, the talk and the actions of the parties in the years following the execution of the contract up to the time the dispute first arose, because it is our position that under the evidence in this case, and under the indisputable facts in writing, as well as the credible oral testimony, the parties, including the defendant and its predecessor, understood and intended that the price protection clause, paragraph 6, did not contemplate or provide for any allocation of so-called overhead or indirect charges of the defendant's plant or business as a part of the actual advance in the

cost of manufacture of gypsum. Of course, in that connection, your Honor, I will later refer to the expert evidence in this case and show to your Honor that [5] the testimony of the plaintiff's experts is the evidence that has actual probative force and is credible, and that the testimony of the defendant's purported experts absolutely ignore the provisions and purposes of this contract, and for that reason alone their testimony must be disregarded and the testimony of the defendant's experts accepted. But I repeat again, for three separate reasons, the plaintiff's contentions and position with reference to the proper interpretation to be given to paragraph 6 should be accepted: First, the proper interpretation of the contract, itself, and the language of the contract; second, prior and contemporaneous construction given it by the declarations and actions and conduct of the parties; and third, upon the evidence that has been offered to your Honor from the experts. In connection with the last separate and independent reason that I will develop in more detail at a later juncture of this argument, I want to bear in mind, your Honor, at the outset, that this trial, as in his deposition, Mr. Barrows in talking about the discussions he had with Mr. Colton leading up to the execution of this contract and the language of paragraph 6, never once said that he intended or understood that this clause should cover overhead or indirect expenses. The most that his testimony can be said to convey, accepted in its most favorable light and ignoring all the conflicts that appear in

his testimony before the court and that given in his deposition, and as contradicted [6] by Mr. Colton, there was not a word of it that he ever told Mr. Colton, that he ever expected or intended this contract to provide for the allocation of overhead or indirect expenses. All he was concerned with was that he did not want to limit himself (so he said before your Honor at this trial), to the three items, and only three items, which he proposed as the basis for any price increase, namely, an advance in the cost of labor, fuel and supplies. As a matter of fact, if your Honor please, as plaintiffs have construed this contract, they at all times have been willing to allow many costs in addition to those three Mr. Barrows first proposed. We have allowed repairs. We have allowed all costs of supplies and materials that have to do with the manufacture of the gypsum. We have been willing to allow depreciation, taxes and insurance upon the physical plants or that part of the plant that is used for the processing of gypsum—in fact, all the costs and expenses that defendant has, which are incurred and necessary to the production of gypsum, and which would not exist if the gypsum was not produced. In other words, we are not only willing to pay the actual manufacturing cost, but the depreciation of the physical plant and the direct shipping expense, which was not originally proposed by Mr. Barrows, and the taxes and insurance, providing taxes and insurance and depreciation are based upon a proper method of allocation. The defendant admits here that they roughly allocate

them upon their [7] relation to value. In a contract of this kind, particularly where the plaintiff has consistently attempted to live up specifically to the terms of the contract, something roughly approximated is not the proper method. We feel, and the evidence clearly shows, that it is entirely possible to charge a proper rate of depreciation, not on the basis of the method the defendant has proposed, the straight line method, but in relation to the tonnage produced; and as to taxes and insurance, it is a very simple matter, or should be if the defendant is willing to comply with the contract, to determine the cost of insurance and taxes upon the physical part of the plant used for processing this by-product gypsum. We will pay it. Consistently that has been our position.

But I want to preliminarily point this out to your Honor: Mr. Barrows testified in his deposition and even on the witness stand, that he said, "I propose, instead of specifying the particular items of cost, that we leave it to the accountants." That was his testimony before your Honor, and was his testimony in the deposition.

What is the position of the plaintiff with relation to that? When this dispute first arose in 1944, seven years after the contract was adopted, the plaintiff said, "All right, we want to go ahead with this contract. We made plans upon promises that you made in this contract covering a period of years. We want to comply with them. We want to live up to [8] it. You are wrong now in taking a different stand than you have heretofore taken.

But to reconcile this contract, we will do as Mr. Barrows first suggested, and finally suggested when the term, according to Barrows' testimony, was agreed upon in the contract:

“Leave it to the accountants. You appoint your expert, we will appoint ours, and the two will appoint an impartial expert and let him decide what costs shall be included in the actual advance of the cost of the manufacture of gypsum.”

Now, we were entitled to ask that because Mr. Barrows has told your Honor in his testimony here that that is what was the meeting of minds. But now the defendant would not agree to that. I think that that point is significant, your Honor, not only as to show the question of good faith, to show what the parties had in mind, but also to check the force and effect of this purported expert testimony that the defendants have produced before your Honor. If, according to good accounting principles and practices the actual advance in the cost of manufacture of this by-product gypsum included this arbitrary allocation, and the witnesses for the defendant finally admitted that whether you do it on a labor basis, which the defendant's witness Farquhar said was not the proper basis for allocation, or any other basis, it would involve an arbitrary allocation which would not determine actually the [9] relation of any cost. But they would not do it, and they have consistently refused to do that, your Honor, and the only reason obviously for their refusal is that they

know that any qualified, impartial accountant would rule against them, and would rule in favor of the position the plaintiff has taken from the beginning.

But let us go back for a moment to the genesis of this transaction. They started a plant down in Newark. Mr. Barrows was president of the defendant's predecessor. This plant was started prior to 1931. Two years prior to that time they had a pilot set up to explore the matter of manufacturing bromine and magnesium compound from the bittern water that they were obtaining from the salt company. Mr. Barrows at the trial here attempted to convey the thought to the court that this plant was built really to produce two main products, magnesium and gypsum. Of course, this is disputed **by the written statement of the executive vice president of the defendant's corporation**, who in 1931 wrote this article which your Honor had before you as an exhibit, showing the pictures of the plant down there and describing the purpose and processes, and the article makes it plain that the purpose of that plant was to produce bromine and magnesium and, moreover, he says as early as 1931 it actually started production. Mr. Seaton said:

“Accordingly, after extensive laboratory investigation and some two years' pilot operation, a small plant [10] for recovery of these values in other forms is now in production and a large plant is being engineered.”

The forms he was talking about were the magnesium products. No reference made at all to gypsum in that whole article except one little sentence, which reads as follows:

“The by-product gypsum from the process through operation of favorable location factors, is marketable at a profit instead of being a valueless waste.”

In 1936 Mr. Barrows approached Mr. Colton. By the way, that favorable market factor, it has been admitted by Mr. Barrows, consisted of the plaintiff's plant being located over there in Redwood City, just a short distance across the neck of the bay from the Newark plant of the defendant. Mr. Barrows approached Mr. Colton and made a proposition to him, and it provided several things. It provided that the California Chemical Company, the defendant's predecessor, would buy oyster shells from the Pacific, the plaintiff, and would sell the gypsum that they produced at the plant, except 3000 tons, which they would reserve, and it also provided that they would sell to the defendant quicklime and hydrated lime at a certain stipulated contract price. The contract price for gypsum then proposed by Mr. Barrows was \$2.60 a ton, 20 cents a ton less than the contract finally provided. In that first proposition Mr. Barrows said, “The contract would contain certain price protection clauses to guard against increases [11] of labor, fuel and supplies”—only three of a number of actual or direct costs of producing gypsum, which the plaintiff under this contract has at all times been willing to allow. Again, after some negotiations back and forth, Mr. Barrows again came along with a proposal to Mr. Colton in his letter of September 18, 1936, including a rather

rough draft of an outline for a contract for the sale of lime and gypsum by California Chemical Company, the defendant's predecessor, to the plaintiff, and that proposal stated that the price would be \$2.88 a ton, which price was based upon the defendant's direct cost of manufacture. In other words, the contract price in this case, in this final contract, was the sum of \$2.88, and according to the written declaration, Mr. Barrows in his admissions before your Honor, that price of \$2.88 was based upon the direct cost. They were not thinking at that time of figuring as a part of the cost of gypsum this so-called overhead of doing business. That proposal of September suggested that there should be a price protection clause for both lime and gypsum, based upon the average direct cost and protect against price advances, labor, transportation, fuel or supplies—again a few and a limited number of actual or direct costs, which, as I say, plaintiff has been willing to allow.

There is some dispute in the testimony. Mr. Colton says there was no discussion with Barrows, no contention by Barrows about the meaning of the words "cost of production" or limiting [12] the cost of production as a basis for any price increase on allocated or other costs. He said the only discussion, according to his recollection, had to do with specifications in this draft. He said the matter at that time then was turned over to counsel for both parties and counsel finally got together and drew the agreement, which was finally signed on the 29th of January, 1937, and paragraph 6 in that contract provides:

“In the event that California’s cost of production of gypsum for any twelve months’ period during the term hereof shall increase 5 percent above its average cost of production of gypsum for the preceding twelve months’ period, then and in that event California shall have the right, upon giving sixty days’ written notice to Pacific, to increase the price payable hereunder for gypsum thereafter delivered hereunder in an amount not to exceed the actual advance in California’s cost of manufacture; provided that in no event **may** more than one such increase be made in any one calendar year.”

Then there is the further language, which is significant, your Honor:

“California shall keep books of account and records showing the defendant’s production cost of gypsum, and such books of account relating to the cost of the production of gypsum shall be open to inspection by Pacific at [13] all reasonable times in order to enable Pacific to confirm the correctness of any advance in price permissible under this paragraph.”

Now, there is another provision, if your Honor please, that I wish to call to your Honor’s attention, and it has been ignored entirely by the defendant. In fact, it has been utterly contradicted and disputed by the whole theory of their case, and that is the opening paragraph of the contract:

“Whereas California contemplates the erection of a plant located at canal head, Newark,

California, primarily designed to produce magnesium oxide in its various forms, which plant will produce as a by-product substantial quantities of gypsum.”

That particular paragraph must be considered and should be considered, if your Honor please, in connection with paragraph 6. It shows, I submit, on the face of the contract, a declaration which the parties cannot dispute either, as to the question that gypsum is a by-product, and they labored before your Honor with their witnesses and counsel's contention that gypsum is not a by-product, that it is in fact a main product. But here is Dr. Seaton saying it was a by-product, and the contract itself says it was a by-product. The character of gypsum as a by-product cannot, I submit, be disputed. The contract precludes them on that. But it has the further significance of showing in relation to paragraph 6 that it was not intended by [14] this contract that the overhead cost of running the plant should be part of the cost of gypsum. Otherwise, what is the purpose of this sort of language? It says that the plant is mainly or primarily designed to produce magnesium oxide, and that could only lead the plaintiff to believe and understand that if there is to be a construction that all of these overhead costs of doing business, the bookkeeping, and the plant guards, and all that sort of thing, that has to be borne by the primary product, and that gypsum, the by-product, so far as determining its cost, should be limited to the costs which are actually required in the produc-

tion of that by-product. That is in keeping with common sense, and it is spelled out in specific language in the very introduction of this contract.

The Court: Gypsum in large quantities.

Mr. Bennett: Yes. It says in the first paragraph of the contract, "California contemplates the erection of a plant located on canal head, Newark, California, primarily designed to produce magnesium oxide in its various forms, which plant will produce as a by-product substantial quantities of gypsum"—just as a person opening up a sawmill, reverting to that illustration, would produce substantial quantities of sawdust if we were dealing with a contract having to do with the sale of sawdust. But the point is so far as that particular paragraph of the contract is concerned, and particularly in relation to the question of the interpretation of paragraph [15] 6, it further shows that the overhead, the cost of running the plant down there was contemplated and intended by the parties to be borne by the primary or the main product, the purpose for which the plant was built.

I pause at this junction, if your Honor please, to go away from the contract and back to Mr. Barrows' contention, because, as I told your Honor, these declarations and statements of the parties prior to the execution of the contract are important as a separate and distinct element of evidence and proposition to support the plaintiff's construction of this contract, particularly in view of the contention of the defendants that the term "actual advance in cost of manufacture" is uncertain or

ambiguous. I pointed out to your Honor that in the two written proposals that we have in evidence, and the only writings that we have in evidence prior to the execution of the contract, the one in June, 1936 and the one in September, 1936, indicate that Mr. Barrows at that time had no idea of charging overhead or allocating, arbitrarily or otherwise, overhead to this cost of gypsum. Admittedly, the price of \$2.80 was based upon the direct cost, the actual cost, which does not include overhead or indirect items, and his two proposals in writing that he has made to the plaintiff both say, "All we are interested in is protection against the cost of labor, fuel and supplies." He has even limited himself to a few—three—of the several items of actual or direct loss which [16] the plaintiff has at all times been willing to allow. Now, when he came before your Honor he attempted to make some explanation here of some discussions or objections that he had to these proposals. He says the reason for his objection was because of limiting the price increase to labor, fuel and supplies because the plaintiff would not agree to a cancellation clause in favor of the defendant, in favor of Mr. Barrows' company.

Now, Mr. Barrows was cross-examined, your Honor, with reference to his deposition. The deposition was taken some months before. He was a sick man when he testified before your Honor; he may have been ill at the time of his deposition, but I was not apprised that he was in any sense under his disability, and perhaps his disability at

the trial is responsible for his difference in testimony. The purpose of that deposition was, of course, to pin Barrows down to everything that was said by him or Colton leading up to the execution of the contract. In his deposition he did not say a word about discussing with Colton this cancellation clause. In his deposition all that he said was that Colton wanted a provision in the contract that the defendant, or Mr. Barrows' company, would keep books satisfactory to Pacific, and he objected to that because he did not know what would be satisfactory to Pacific, and so he said. "Let's leave it to the accountants. Let's put in 'cost of production' and leave it to [17] the accountants.' " It will only take me a minute to read some of Mr. Barrows' testimony on his deposition.

Mr. Rosenberg: Where are you reading from?

Mr. Bennett: I am reading from page 846 of the transcript of the trial. I am not reading from his deposition, but I am reading from the transcript of the trial as to what he said on his deposition. These questions were asked:

"Q. Well, at that time"—you were referring back to June 5th and September 18th, 1936—"you were proposing that any increase in price by reason of any increase in cost should be limited to those increases in direct costs, such as labor, supplies and/or materials and fuel? Wasn't that so?

A. I wouldn't think so, Gene. It is a starting point.

Q. Well, did you have—

A. And I know we had a lot of talks on that afterward.

Q. Well, did you have any—withdraw that. What talks did you have afterward, and with whom, concerning that?

A. Mr. Colton and myself talked on numerous occasions.

Q. You mean after—

A. After this preliminary draft.

Q. Of September 18th? A. Yes.

Q. And what was said concerning that?

A. I couldn't answer that. [18]

Q. You have no recollection?

A. No. I know that we talked on a lot of points, because this final contract, I believe, would show that we didn't follow this.

Q. You don't recall anything specifically said by you—

A. I can remember discussing the cost matter, I can remember discussing this amount clause, how much they were to get, you know; I can remember discussing in a general way chemical specifications to this extent: He said, 'Well, what are your chemical specifications?' I said, 'I don't know a darn thing about chemicals,' I said, 'You pick a man who attends to those things from your organization and I will designate a man from the California organization and let them determine what your chemical specifications should be.' We did put in quite a lot of work in arriving at that point, but what the words were I couldn't tell.

Q. But you don't have any recollection of any specific discussions with Mr. Colton or anyone else connected with or representing the Pacific Port-

land Cement Company with reference to the nature or type of costs that would be such as to entitle you to an increase in price?

A. Well, what would entitle us to an increase was what we would finally decide upon, and we did talk that thing out and it took quite a long time, and that is what resulted [19] in their finally changing the thing to just cost of production. My thought was to 'leave it to the accountants, what cost of production is.'

Q. Do you recall anything specifically that Mr. Colton said with reference to that? A. No.

Q. Do you recall anything specifically that you said, other than 'leave it to the accountants, what the cost of production is'?

A. That is my final remembrance."

And then counsel asked me to read other parts of the deposition and I did read what he asked, and I now quote from the bottom of page 849 of the transcript:

"Mr. Bennett: Q. Will you state what that bone of contention was?

A. Well, it is pretty hard to remember, but I do recall this: In one case, in one of the drafts they submitted—well, I don't even know what you have in your file. You may have that. If I could see it, I could tell better, but we got to discussing what would be costs. I did not want to limit it to the first items that we had outlined, because we got to figuring that we were going to have to put up the plant to make this gypsum. At first we thought we could put in a drier and then later it transpired

we would have to put up a plant and put in equipment, and [20] Colton put in a paragraph that the production costs— we were to have the right to decrease—keep records of the costs of production in form satisfactory to Pacific, and I said, ‘No, we can’t do that, because I don’t know what “form satisfactory to Pacific” might mean. It might mean anything.’ And then I suggested, I countered with a ‘form in keeping with good accounting practice—accepted practice, and I left that note with Williams, and I think—again it is awfully hard to remember these things ten years ago, but I think they said, ‘Well, we will just put in “cost of production” and that will cover it. It is too involved to try to outline what every cost of production is.’ This is my recollection.”

There was nothing said by Barrows in his deposition, although he was repeatedly questioned as to what conversations he had with Colton, about any cancelation clause. But what is more important, and what I think is decisive and determinative in this case, striving as poor Mr. Barrows did on this witness stand with a different story than he told in his deposition, he did not say by word or inference that it was intended by him or sought by him or intended or sought by Colton that this term “actual advance in cost of manufacture” as the basis for a price increase should include overhead or an allocation of indirect and other charges. I submit, if your Honor please, in view of the fact that the evidence so clearly shows in [21] indisputable form that all that he wanted in the begin-

ning was just three of the direct costs, fuel, labor and supplies, and that there isn't any credible evidence to show that at any time there was any meeting of minds or an intention even to assert that there should be included an allocation of overhead and indirect items, that that shows, aside from the language of the contract, and certainly it supports the language of the contract as we contend it should be construed, that the parties considered only and were only seeking and only intended by this final contract which was executed, providing a so-called price protection clause, increases that occurred in the actual cost of the production of gypsum, not any arbitrary loading of overhead and indirect items of the plant down there that was primarily designed, as the contract admits, for the production of magnesium oxide.

I come to the next step of the chronology, your Honor, that I think is important. How did the parties treat this contract for a number of years? The contract price of \$2.80 a ton was paid until 1941 and then for the first time the defendant asserted an 18 cent price raise. Prices had gone up, as your Honor knows, at the beginning of the war period. Mr. Colton called down at the plant down there. He testified no one at the plant or otherwise had told him they were basing an increase on overhead or indirect items. But we have again a writing that can not be disputed. Here is this letter of October 2, 1941. It was sent to Pacific by Westvaco. It says,

“Gentlemen:

“In accordance with request of yourself and J. H. Colton, while in conference with Mr. Wallace yesterday, we have analyzed gypsum production costs for the years ending June 1940 and June 1941. We are attaching hereto a recapitulation of labor, material and power costs, which accounts for 15 cents per ton of the 18 cents per ton increase of which you have been previously notified, and which increase is effective October 5, 1941.

“If you desire further information in re the attached statement, or in connection with our basis of determining increase in costs, please call on the writer.”

And attached to that was the outline entitled “Gypsum Manufacturing, July 1939—June 1941,” in which they show a two [23] cent increase in labor, a ten cent increase in materials, and a three cent increase in power. Clearly that writing, if your Honor please, shows that at that time, years after the contract had been executed and when the first price raise was sought to be made, they did not assert that they were entitled to make a price raise on allocated items of overhead. But they say here that 15 cents of the 18 cents accounts for only three items of direct cost, and assuming that the other three cents involved one or more of the other items of direct cost, which the plaintiff at all times has been willing to recognize, we paid that sum of money and it was only after O.P.A. was in effect, and after, in 1944, when they sought the second price raise, that we were told they

based this first price raise on indirect costs. Then they contended for the first time that instead of being 15 cents out of the 18 for labor, fuel and material, that there was only a 9 cent raise in direct costs, something entirely contradictory and inconsistent with the written notice and the declarations that they made at the time that the first price raise was made.

If your Honor please, I think that that fact, contemporaneous construction, which is always of the utmost importance when the question of the interpretation of any clause of a contract is asserted, should alone persuade your Honor or any judge to hold against the contentions of the defendant in this case.

Obviously, my time is running to a close and I shall not [24] be able to develop this argument except to hit the high spots, if your Honor please.

We discussed this burden of proof proposition. The matter is briefed in our briefs. The contention by counsel, simply stated, is that merely because we brought this suit we have the burden of proving that their asserted price increases are not proper. Obviously that is wrong. We have cited a number of cases to your Honor that the mere fact that in a declaratory relief suit, plaintiff brings the action, does not make him carry the burden of proof. It is the person who has the affirmative of the issue who has the burden of proof, and the defendant in this case has the burden of proof and the affirmative of the issue on the matter of whether or not there is an increase

of price. I will not take any more time in this argument, your Honor, to mention that because the matter is covered in the brief and I am satisfied after reading those authorities, and even considering one or two other authorities that indicate to the contrary, your Honor will find not only by the balance of considered judicial opinion, but with the common rule of reason, common sense, the defendant has the burden of proof.

If your Honor please, on the question of the contract and its application we have cited cases on both sides with reference to the meaning of the term, "Cost of Production," or "Actual Cost of Production." In all cases cited by the defendant [25] it did not involve a situation of this kind where we had a by-product or where there was a matter of allocation, except in one case, the Ford Motor Car case, which I will not discuss here in argument other than to say that in that case the court held that by allocation you do not determine the actual costs and the only reason they allowed allocation there was because Ford had consistently followed an allocation purpose, and it was a suit by a patent owner for infringement, and he was claiming as a basis for his infringement not only a saving of the actual cost but the overhead as well. The case is entirely distinguishable and the court in that case states you do not determine actual cost by any process of allocation.

On this matter of uncertainty, I want to say just one word about that. Though laboring for twenty pages in his brief, counsel has been unable to cite

any case in which the courts have held invalid a contract because of the uncertainty of the words "cost of production." The courts have said in many of the cases cited that this term requires other evidence to explain it, but in each instance the court has applied that evidence in keeping with what it found was the intention of the parties and upheld the contract. The only instance where the court held invalidity was in the case of a criminal statute where, of course, the rule is entirely different.

If your Honor please, I want to say one word—and I feel I am doing a wholly inadequate job. I must close. I think I [26] started 15 or 20 minutes past ten, and I want to allow counsel an equal time with your Honor's indulgence—about the testimony of these experts.

Despite the fact that the contract says that gypsum is a by-product, all of the defendant's witnesses in saying that they would allocate overhead, and so forth, admit, if your Honor please, that that would involve something arbitrary. It might be all right if only the interest of the manufacturer was concerned. And they were dealing with that situation. They were not dealing with a case where the contract required something actual and definite. And each of them admitted that they saw no difference or distinction between accounting for a by-product and accounting for a main and a co-product. Every one of them took that position flatly. There was an attempt to show, "Oh, the books, the authorities report that." They do not.

Your Honor will recall that I produced this handbooks here when the witness Maxwell said, "Yes, that is a very authoritative book and it is a compendium of all the other books," and I showed in that case there is a definite distinction and difference between by-product accounting and accounting for a co-product and a major product, and I showed an instance where in the coke industry the main product was charged with the overhead and the by-product was not. I showed that in the majority of instances they did not figure only the cost of a by-product but credited sales of the by-product against the cost of manufacture [27] of the main product.

And then he said, "I do not like that. I don't think the book should draw any distinction. For that reason I don't like the book."

We produced four outstanding witnesses, if your Honor please, men of the highest standing and repute in the accounting profession. All of them were unequivocal in saying that in a situation dealing with a by-product you should charge against it only the cost of its production, the things that would be involved in producing it. You should not include things that would go on if the by-product was not to be produced. And I think, if your Honor please, that Dean Jackson summed this thing up in a sort of homely commonsense fashion that should appeal to the Court. He said, "Most business men would not include as a charge against that by-produce that portion of the general overhead which would go on just the same, whether the

by-product was produced or not. In other words, the product must stand on its own feet as to whether or not it will pay the organization to produce that product from the time it is split off from the main product, and if it will not, any sensible business man would not proceed to produce it."

And in this instance, if your Honor please, the defendant does not have to produce gypsum according to its contentions. It can produce other products out of these sulphates that otherwise would be a waste, and which are necessary to remove from [28] the bittern in order to produce the main product, magnesium oxide. It is told us repeatedly, "If you don't pay us our demands, everything we demand, we are going to stop it and we will produce other products and the contract will be at an end."

Why, they have something better than an escape clause in this contract, as far as that is concerned, than that possessed by the plaintiff. According to their contentions and statements, they can stop manufacturing this gypsum at any time and use the sulphates for some other purpose. Dean Jackson said it is just a matter of commonsense, and I think that is the rationale of the rule that was relied upon by each of the plaintiff's witnesses in this case, and the testimony of the defendant's witnesses on this accounting point can not be accepted because they ignore the provisions of this contract, which are based on the manifest purpose and the obvious intention of the parties as revealed

by their declarations and by their conduct, both before and after the contract was executed.

I have not argued, if your Honor please, this case in any detail that I would like, particularly pertaining to the authorities applicable. Perhaps the best way to consider those authorities is in the brief, but I submit, if your Honor please, it is shown by our briefs that the authorities are entirely in support of the plaintiff here, and the authorities that have been cited against us are all distinguishable.

There is one point on this sulphuric acid matter which I [29] wish to point out to your Honor and then I will close and I will rest the argument concerning paragraphs 5 and 3 of the contract upon the argument we have submitted in the briefs.

The Court: Briefly stated, with respect to paragraphs 3 and 5, what am I to determine in relation to paragraph 6?

Mr. Bennett: Paragraphs 3 and 5 have no relation to paragraph 6. They are separate issues. Under paragraph 5 your Honor is to decide as to whether we are entitled to deduct for fractions. For example, it provides, as your Honor knows, that if it falls below a certain percentage we are entitled to deduct 10 cents per ton. Consistently the plaintiff has deducted for fractions. For example, if it falls 2.9 per cent below the allowed tolerance, we deduct 29 cents, and that seems to be an exact and fair transaction. On the other hand, the defendant contends that we can only deduct 20 cents, that it has to be a full per cent before any deduction can be made.

There is another issue under paragraph 5 as to whether the samples should be by carload lots or by weekly production; they would screen something like 20 carloads. Historically and through the years we have always had carload samples until 1946, and we say that that practice should continue because the carload is the unit of measurement so far as deliveries are concerned, and the defendant should not be permitted now to change it and give us a sample only of a whole week's production or approximately 20 cars simply so that it may average out [30] and gain perhaps by that averaging process. The same practice that has been followed for years should prevail now. It is consistent with the contract and the only fair and accurate way in which to determine this question of quality.

The other issue as to paragraph 3, if your Honor please, simply is a question of law to be determined from the contract language. We say that we have two separate rights: one, to refuse in excess of 2,000 tons per month and also to refuse independently of that more than 20,000 tons per year. The contract is perfectly plain on that, and the defendant's contention is that we must elect one or the other, that we can not have both. There is nothing in the contract to support counsel's contention in that respect, and it is a simple matter that I submit your Honor will very easily decide from the plain language of the contract.

I want to say one word about sulphuric acid because that is an important thing. Your Honor recalls under the evidence up until 1946 there was never any charge against gypsum for sulphuric acid, and then suddenly they switch this charge of sulphuric acid because they say, "Well, we stopped producing bromine and sulphuric acid is desirable or necessary for the filtering out of the gypsum; so we charge it now all to gypsum." That charge is not right. It is not an overhead or an indirect charge in the strict sense. Had they in the beginning made the charge of sulphuric acid to gypsum, and if sulphuric acid was [31] used and necessary for gypsum production, then there might be a different situation, but I say they can not go on for ten years making no charge for sulphuric acid and now at a later date, when they are trying to build up, pad and load their costs as they did with indirect shipping through a value basis when all during the preceding years it was on a tonnage basis, they can not suddenly, in the comparatively later period of the contract, make a charge for sulphuric acid which at no time had been charged against gypsum. As our witness Kleckner testified, this sulphuric acid is necessary and desirable for the manufacture of the main product, magnesium oxide. That is what it is used for and that is what it serves; that it has no function particularly so far as the manufacturing of gypsum is concerned, and as Dr. Seaton said in his article. this thing goes through the whole process. Obviously, there is no proper basis for a charge of sulphuric acid sur-

denly to arise in 1946. It is neither a proper charge against the gypsum and, secondly, they can't entirely eliminate it in one year and add it in the next simply because they stopped the production of bromine. Think of what would happen. One year they would produce bromine and charge all the sulphuric acid to bromine; next year they would charge all that to gypsum and switch back to producing no bromine, and then that builds it up and every other year they could add, in a pyramiding and compounding fashion, a charge for sulphuric acid which perhaps in ten years might amount to \$2 a [32] ton. It would produce a perfectly absurd and ridiculous result. For several reasons it is improper, if the Court please, to allow any charge against gypsum of this sulphuric acid.

I am sorry that I have gone so far, but I felt I should spend considerable time with some of these facts, if Your Honor please, that I think certainly point the way to give an answer to the issues which are presented before Your Honor.

The Court: We will take a recess.

(Recess.)

ARGUMENT ON BEHALF OF THE DEFENDANT

Mr. Rosenberg: If Your Honor please, I am not going to attempt to re-argue everything that is contained in the briefs. I guess the briefs are longer than the Court anticipated, and I realized it would cast considerable burden upon the Court, but as much as I tried, I just could not confine it to a shorter brief than was eventually filed. So I am

going to devote myself primarily to a response to some of the things that counsel stated, and first I would like to direct the Court's attention to this question of the statement that was submitted by the defendant to the plaintiff in 1941 showing 15 cents of the 18-cent increase that went into effect at that time. Counsel referred to that and would have the Court infer from the circumstances that at the time the 18-cent increase was made effective the defendant rendered a statement which was based only upon direct costs, and it was not until 1944 that the defendant took [33] the position that all costs which even plaintiff's so-called experts admitted are properly includable in determining the cost of production of a manufactured product should be included. Now, the facts with reference to that statement are as follows: Your Honor will recall that a notice was sent from the defendant to the plaintiff that pursuant to paragraph 6 of the contract, defendant's cost of production in the period from July 1, 1940, to June 30, 1941, having increased 18 cents over the preceding 12 months' period, therefore the price would be escalated pursuant to paragraph 6 of the contract from \$2.80 to \$2.98 a ton. Counsel neglected to mention to you what the testimony shows, and that is that following the receipt of this notice there was a conference at the office of the defendant between the accountant for the plaintiff and the accountant for the defendant, the purpose of the conference being to enable the plaintiff to review the defendant's figures and ascertain the propriety of that 18-cent increase. The

evidence is uncontradicted that they spent several hours together and no question was raised at that time, so far as the evidence shows, by the plaintiff as to the propriety of that 18-cent increase. The evidence is uncontradicted that at that time Mr. Camden, the auditor for the plaintiff, requested that certain information be furnished by the defendant to the plaintiff in the form of a statement, and it was pursuant to that request that the statement to which counsel referred was sent, and it showed a [34] 15-cent increase in labor, materials and fuel. Obviously that statement did not purport and was not intended to substantiate the entire increase of 18 cents. It was not rendered for that purpose, it did not purport to be for that purpose, and the letter of transmittal expressly said, "This is rendered in accordance with your request and if you want any further information, please do not hesitate to call upon us." The inference is irresistible that either the plaintiff knew what the balance of the 18-cent increase was or at least there is no evidence in the record that there was any misrepresentation or any withholding of information or that there was ever any request made by the plaintiff of the defendant for any further information. The first time that such a request was made was in January of 1944, when Mr. Flick first entered the picture, and then he for the first time requested a statement showing the full 18-cent increase, and it was pursuant to that request that the second statement, which is attached to Defendant's Exhibit A, was furnished, showing the full derivation of the

18-cent increase. Counsel would have a Court infer or understand that there is some conflict between those statements. The fact of the matter is there is not, if the Court please, and if the Court will compare those two statements you will find that as to the items shown on the first statement, the comparable item shown on the second statement are identical. For instance, in the first statement labor was shown during the first period at 30 cents a [35] ton and in the second statement it was likewise shown at 30 cents a ton. Material was shown at 12 cents a ton in the first statement and 12 cents a ton in the second statement. Power was shown at 11 cents a ton in the first statement and 11 cents a ton in the second statement. Those are the only three items that were covered in the first statement, apparently the only three items as to which the plaintiff requested the figures, and they are identical in the second statement; so that there is no conflict between those statements nor is anything in connection with the rendition of those statements such that would justify the inference that in making the 18-cent increase the defendant was including only direct costs or was interpreting or construing the contract to mean that only direct costs are to be included in determining cost of production.

The same thing is true as to the second period. The first statement shows 32 cents for labor, the second the same; material 22 cents in the first statement, the same in the second; power, 14 cents in the first statement, 13 cents in the second. There is a penny difference there, which apparently re-

sults from a rounding off of fractions. I submit, if the Court please, that is a completely unjustified argument and an attempt to distort the facts when counsel argues that from the fact that this first statement was rendered the Court can construe that the defendant's own conduct has construed the contractual language to mean only direct costs. [36]

The same thing is true as to counsel's statement regarding the negotiations that preceded the execution of this contract. I think it is a significant fact, and Your Honor will recall that when the plaintiff was presenting its case, the only evidence that plaintiff offered that would shed any light upon the negotiations between the parties, and therefore the intent that they had in mind when they adopted the contractual language, was this one letter that was written by Mr. Barrows on June 5, 1936, which was seven months before the contract which is in litigation here was executed. That letter referred to a contract that is utterly different from the contract that was finally entered into. It contemplated a contract whereby the defendant was going to purchase oyster shell from the plaintiff and the defendant was going to sell to the plaintiff lime and gypsum. The contract that we are concerned with in this litigation is a contract providing solely and exclusively for the sale of gypsum from the defendant to the plaintiff.

It is a very significant fact that in these preliminary negotiations, and at a time seven months before the execution of the contract, Mr. Barrows,

at the request of Mr. Colton, sent him a letter in which he said, "This is purely preliminary. There are a lot of things we will have to straighten out, but you have asked for my general outline as to what I have in mind, and here it is." It provided for the purchase of oyster shells. That is not in the contract. It provided for the sale of lime [37] by the plaintiff to the defendant. That is not in the contract. And it provided for the sale of gypsum by the defendant to the plaintiff. That is the only thing that is in the final contract. But the thing counsel would try to skirt over is it also said that the defendant is to have the privilege of canceling the contract at any time upon 15 months' notice. That was seven months before the contract was signed. That was the only evidence that the plaintiff put in the record, and they had Mr. Colton, the contracting party, sitting in this court at all times while they were presenting their case, and they deliberately refrained from closing that gap of seven months between the time that this preliminary communication was written to the time the contract was executed. Why, if the Court please, didn't plaintiff undertake to close that seven months' gap when many things transpired between the contracting parties, except that they knew that the only rational and logical explanation of what did transpire, and why that language that Mr. Barrows proposed did not in fact get into the final contract would be adverse to their contentions. We called Mr. Barrows and we had him fill that gap and tell what transpired between the time of these purely

preliminary negotiations seven months before the contract was executed, and incidentally, Mr. Barrows was not a sick man on the witness stand. He did not profess to be, and we do not claim he was. He has a chronic condition that requires him to take care of himself. But there was nothing [38] wrong with him while he was on that witness stand, and we do not claim that there was, and his testimony is 100 per cent so far as he is concerned. We make no excuses for his physical condition. We did not at that time except we did not want him held over to the afternoon session because he was supposed to go home and lie down. And what did Mr. Barrows say and what could Mr. Colton say to deny it? Mr. Barrows said that they had a number of conferences after this letter was written, and then finally in September—and we are still four or five months before the contract was executed—Mr. Colton said, “We have proceeded far enough. Let’s get the thing down in black and white and send us a draft of what you have in mind.” So Mr. Barrows sent Mr. Colton a draft, and that draft again contemplated the purchase of oyster shell by the defendant from the plaintiff, and the sale of both lime and gypsum by the defendant to the plaintiff, and that contract likewise included a clause which gave the defendant, not the plaintiff, a cancellation privilege. Your Honor will recall that in the final contract the situation is exactly reversed. The plaintiff can cancel this contract at any time it wants to. The defendant is stuck with it for 25 years, whether it likes it or not. Mr. Bar-

rows said that that was the bone of contention between them, that Mr. Colton insisted that not only would he not agree to a cancellation privilege upon the part of the defendant, but he insisted that the plaintiff have the exclusive [39] cancellation privilege. So then Mr. Barrows said, and his testimony is entirely logical and consistent, that he started thinking: If he was going to enter into a 25-year contract where his firm is bound to the contract for that period of time and the other contracting party can cancel at any time, then he had better give a little more thought to the question of price, because if things got out of hand they would be stuck with the contract and they could suffer substantial loss.

So that is his testimony? Plaintiff says that we have misquoted it in our brief, and I would like to quote it to the Court exactly from the transcript, and we did not misquote it in our brief. He says this:

“The discussion come down to conditions referring to production, cost of production, items of production cost. During this discussion I said, ‘Well, that is not sufficient, just the items.’ I said, ‘I wouldn’t be limited to those items, there are other items that go up to make up cost of production,’ and we argued. I mentioned a number of items. He said, ‘We can’t put all these items in.’ I said, ‘If we can’t do that, then make it the cost of production and we will let the accountant decide what cost of production is.’ That was the point of the conversation.”

So what is the substance of that conversation? He had originally suggested labor, materials and fuel and a cancelation [40] clause. Colton objected. He not only objected, he said, "No, you get a cancelation clause but we get out." Then Barrows said, "We are not willing to submit to direct cost"—this is the gist of it—"there are too many things that enter into it."

Colton said, "We can't put everything in there." And the Court will keep in mind that these are not accountants negotiating with each other and they did not profess to be accountants. They would not know what cost accounting was, I am sure, in a detailed and technical respect. So the sum and substance of it was that they mutually decided, "Well, whereas you, Mr. Barrows, had originally suggested only direct cost when you had a cancelation privilege, and whereas I, Mr. Colton, have objected to that and insist that I have the only cancelation privilege, therefore you will not be confined to only direct cost but we will say 'cost of production.' " and that is whatever it is.

Now, I do not think there is any way of avoiding that interpretation of what transpired between the parties, and I would like counsel to tell me what I asked Mr. Colton on the witness stand and which he was unable to answer. Mr. Barrows had originally suggested that the contract state that his firm would be entitled to a price increase only to the extent of their increases in direct cost. That is exactly what the plaintiff is contending for in this case, and so obviously that language would have

been much more beneficial to the plaintiff [41] than the language that ultimately got into the contract. So how come that language was changed if it was not exactly as Mr. Colton said had occurred. Certainly it would have been more beneficial to the plaintiff to have that precise language in there. We would be out of court, and the mere fact that it is not in there raises the inference which I submit is unavoidable that it is not in there because, exactly as Mr. Colton says, originally they intended only direct cost, and then he said he would not go for that. So it was to include all costs and all costs, according to the testimony of all the experts, including the plaintiff's experts and their tenuous theories of by-product cost accounting that were completely unsupported by any authority other than their own abstract opinions, is that in determining the cost of a manufactured product, it includes overhead. Any business man knows that and any accountant knows it. Mr. Bennett says overhead has nothing to do with the production of gypsum. How could they produce gypsum if they did not have a plant superintendent? How could they produce gypsum if they did not have clerical help and accounting help and meet all those other general expenses that in any well-organized business be net, and where you are making a number of different products must be allocated between those different products on some rational basis? Their own accountants could not avoid that. They admitted that. But then they came up with this theory that that is generally true where you [42] are manu-

facturing a number of products in a single plant; the overhead expense is an essential item in cost of production, but it is not true if you attach the label "by-product" to the thing that you are making. That label changes the whole deal, and when you attach that label, therefore, you do not include overhead, which ordinarily is includable. You include only direct charges.

So here are three independent experts, all from big firms, counsel says. He says you can't question their qualifications. They are all from big firms, Haskins & Sells, and I forget what the others are. They all make mistakes. Haskins & Sells made plenty of mistakes in the McKesson & Robbins case. That does not prove their qualifications. None of them profess to be cost accountants. Here are men who are arrogant and pompous, knowing they are going to be called to testify as expert witnesses on the subject of by-product accounting—and I am assuming now that gypsum is a by-product, which I do not think it is, but it does not make a particle of difference whether it is or not—and counsel says in their reply brief that our whole theory is premised on the basis that gypsum is not a by-product. That is palpably false. Our whole theory is premised on the basis that it does not make a particle of difference for accounting purposes whether it is a by-product or a product, and the hypothetical questions I put to every expert witness that I put on the witness stand assumed that gypsum is a by-product. [43] So their testimony was based upon the assumption, which was an assumption most fa-

avorable to the plaintiff, that gypsum is a by-product. So these plaintiff's experts come in here and they know they are going to be called as experts. They were sitting here on a per diem day after day while Mr. Flick was haranguing here as an expert on every subject in the world. One of them was here for seven days that I know of and he heard my cross-examination of Mr. Flick. When he came up with his expert opinions and I said, "Can you furnish me with any authority, and text writer, any paper that has ever been written anywhere, anything other than your own opinion drawn out of thin air that will substantiate your viewpoint?"

Mr. Flick said, "I have read a lot of stuff but no, I can't tell you anything. That is just my opinion."

So here are these experts sitting here. They knew that I am going to ask them the same question, and so we can reasonably assume that they did a little digging in preparation for their testimony; and still, when I took every one of them on cross-examination, I said, "Can you tell me any authority that will support those views?", not one of them could come up with a single authority.

And then they called the fountainhead of all this accounting knowledge, Professor Jackson. And I argued his testimony was not admissible. Mr. Bennett argued, "Here have been all these experts brought here. Here is a man in the teaching [44] profession. He is it."

So he went on the witness stand under the pretense that he was going to come up with all the

authorities that all the other experts did not have. He had written books even. I asked him, "Did you ever write anything to support what you have said on the witness stand?"

"No.

"Well, have you got anything from anyone else that is in accord with the opinions that you have expressed on the witness stand?"

"No."

So how much weight can the Court attach to witnesses of that caliber? Counsel says our witnesses did not have any authorities either. Now, that is untrue, and the record will show that they had an abundance of independent authority for their views. As a matter of fact, Mr. Maxwell had written a book himself showing that this was nothing that he had concocted for the purpose of this trial. He had written a book himself several years ago in which he expressed the same views he expressed from the witness stand. The only text or authority that counsel has seen fit to refer to is the Accountant's Handbook, but he has distorted the testimony regarding that. He says, "This handbook shows that in the coke industry they do not include the overhead expense in accounting for the by-product." And then he says Mr. Maxwell said when he pointed that out, [45] "Well, I don't like the book." That is probably false and the record will show that it is. Maxwell did not say that at all. Maxwell said, "I do not approve of that, and neither does the book approve of it. The book shows the various methods of cost accounting that are employed, and there are several of them, and

they are progressively more undesirable. This is the third method." What Mr Maxwell said was that the writer of the book did not approve of that method. He was pointing it out, I guess, as a bad example. But the fact remains that both on authority, logically and reasonably, if the expert testimony is to be appraised, it must be concluded that the testimony of the defendant's experts to the effect that in accounting for a manufactured product such as this, where it is an independent plant, where it requires independent labor, that you must include in accounting for the cost of production of that article overhead expense, just as you do in the case of any other manufactured article. And this idea of trying to pin a label on it and saying that that changes the whole approach, it borders on the ridiculous. That little recitation in the contract that the seller is contemplating a plan for the manufacture of magnesium oxide and production of a by-product gypsum, which is in a preamble--will the Court believe that the parties when they entered that contract, entered into that contract, understood that that little recitation up there at the beginning of the contract and before the contractual provision of the [46] contract would have the significance that counsel purports to attach to it at this time, that those laymen understood that, according to plaintiff's experts, that there was this tenuous, complex distinction in accounting between what they call a by-product and a co-product and if these parties did not understand it and they did not have that in mind, the mere fact that it is re-

ferred to as a by-product in the contract is completely irrelevant.

As I say, if Your Honor please, I do not think it makes any difference, and according to the weight of the expert testimony it doesn't make any difference for accounting purposes whether gypsum is a by-product or a co-product. It is not waste. It is not scrap. It is a manufactured product. Maybe it is a minor product. Maybe magnesium oxide is a major product and this is a minor product. That does not change the accounting approach. But the peculiar thing is that if you accept the definitions of plaintiff's own witnesses as to what they conceive of as a by-product, which calls for this completely revolutionary method of accounting, if you accept their own definitions, you must conclude that gypsum is not a by-product. Mr. Flick says, and the other witnesses were to the same effect, and they admit that they had collaborated together and they had agreed on their definition—they had to admit that; they were practically verbatim—that a by-product is something that is purely incidental to the manufacture of [47] another product. It happens accidentally. You can't help but make it, and the quantity of the by-product produced is in direct relation to the quantity of the major product produced. That was their premise. If you knock out that premise, then their whole testimony goes out the window.

What was the uncontradicted evidence? The uncontradicted evidence is that the quantity of gypsum produced is not in direct relation to the quan-

tity of magnesium oxide. The evidence is uncontradicted that throughout the entire time that this contract has been in effect the Westvaco Chlorine Products Company has utilized all the bittern available from the Leslie Salt Company for the purpose of recovering therefrom the maximum quantity of gypsum available; whereas the bittern that leaves the gypsum plant, and which is available for the production of magnesium oxide, has not been utilized to the maximum, and there were periods when a portion of it is wasted. So it is a peculiar by-product where you produce more of the by-product from the mother material than you do the main product, or where you extract the maximum of the by-product from the mother material but less than the maximum of the main product. And Professor Jackson completely knocked out all of the plaintiff's expert testimony when I put a hypothetical question to him and I said, "Assume that you have a commercial plant where you are using a common mother material, and you extract from that the maximum amount of chemical substance A and then [48] you extract less than the maximum of chemical substance B therefrom; would you say under those circumstances that substance A is a by-product of substance B?"

He said, "No," and that is the fact, and it is undeniable that it is the fact. And the weirdest argument I ever heard is the argument the defendant makes in his reply brief, where they say, "Despite defendant's pretensions to the contrary, the fact is that the quantity of gypsum produced is directly

dependent upon the incidental to the production of magnesium oxide." That is an asseveration they are now going to proceed to support. They say that the amount of gypsum produced is dependent upon the magnesium oxide. Now, they are going to prove it. They go on to say:

"For example, in 1943 defendant for the first time began using dolomite in its magnesium process instead of calcium hydroxide, in order to produce greater quantities of magnesium oxide. This change resulted in a decrease of 23 per cent in the tonnage of gypsum produced in 1943 as compared with tonnage produced in 1942."

So, to prove that the amount of gypsum produced is dependent upon the amount of magnesium oxide produced, they argue that in 1943 they increased the production of magnesium oxide and decreased the production of gypsum. So they are proving just the contrary. And furthermore, that statement in itself involves a completely false premise, and that is that the use of [49] dolomite decreased the production of gypsum. Mr. Wallace and Mr. Melhase both testified—and there is no contradiction of it—that the use of dolomite increased the production of magnesium oxide but had no effect whatever upon the quantity of gypsum produced, and that at all times since this contract has been in effect, the defendant had not produced the maximum quantity of gypsum that could possibly be recovered from the bittern that was available from the Leslie Salt Company. That testimony appears at pages 1055, 1056 and 1057 of the tran-

script, and 821 of the transcript. The argument is completely fallacious, and it is based upon a completely fallacious premise.

I want to point this out: Not one of the plaintiff's expert witnesses denied that there are other methods that can be employed in by-product accounting. They each said to exclude overhead. That is what they were called here to testify to and they did. That was only in their opinion; they could not furnish an opinion of anyone else that would support them that that is the proper method; but they admitted that there are other methods, and the very book that counsel presented in court showed that there are seven different methods of by-product accounting. So the evidence of the expert witnesses shows at least there is no single accepted uniform method of by-product accounting. The testimony of the parties themselves as to the negotiations that preceded the execution of the contract, if you are going to take the testimony of both parties, showed that [50] their minds never met on what cost of production was intended to mean. Mr. Colton said, well, he thought it means only direct cost. Mr. Barrows said, "No, I wouldn't limit myself to direct cost. I meant it to mean all costs, according to good accounting."

So we submit, if the Court please, and most sincerely, that under the circumstances of this case—we do not say that in every case the cost of production is a term that is so indefinite that the contract is void for uncertainty, but we say that under the circumstances of this case the court must con-

clude that the minds of the parties never met on the various central provisions relating to the price of the commodity that was the subject of the contract.

If you take the testimony of all the experts, you have a divergence of opinion as between them, but even plaintiff's experts agree that other methods, other than the ones that they contend for, although they claim it is the only proper one, that other methods are employed and other reputable accountants might very well employ them. So certainly the Court can't say that those two laymen when they got together and signed this contract were conscious of all these complexities and complications raised by the experts. So apparently they did not know what the term meant that they were using, and from their own testimony they each had something different in mind; and we submit, therefore, that the contract is void for uncertainty. [51] In response to the request that Your Honor made at the beginning of the argument, a suggestion as to what the Court should do, we feel very strongly that the Court should issue a decree that this contract is void for uncertainty, and therefore that the contract is terminated. Now, it has been argued that the plaintiff, well, how can you declare a contract void for uncertainty after it has been in existence for ten years? There is nothing unique about that. There was no occasion for controversy under this contract until this action was instituted. Certainly not as far as this defendant was concerned, because ever since the con-

tract was entered into, the plaintiff has been paying us the full price that we claim to be entitled to under this contract.

Counsel has accused me in their reply brief of attempting to make a point there that is not justified. My point is not, although I may very well have pleaded it, estoppel; I have not argued an estoppel. I am not claiming that by making those payments they foreclosed themselves from ever questioning the matters that are involved in this case. Let us assume they made some payments under protest. It was only the last couple that they protested, but let us assume this. My point simply is that until this action was instituted we never had any occasion to come into this court and ask that this contract be declared void for uncertainty because we were getting 100 cents on the dollar of everything we claimed. We had no occasion to do it. [52] So they said, "How can you, after ten years' performance under the contract, ask to have it declared for uncertainty?" Why can't we? They for the first time have come into court and have refused to pay us what we claim we are entitled to, and now for the first time the uncertainty has activated a real controversy. And there is nothing unique about that. The books are full of cases where there has been partial performance under a contract and then the defense of uncertainty is urged and the Court determines the contract is uncertain and so declares it, and the party who receives goods or things of value under the contract is obligated to pay on a quantum meruit basis. I won't labor

the Court with that at this time, but we show in our brief how that phase of the case can be disposed of. In any event, we would be entitled to what they deposited in court because according to their own testimony, it is under the market value of the gypsum during the time that they have been making the payments.

So we submit, if the Court please, the contract should be declared void for uncertainty. If the Court decides otherwise, we submit that the evidence preponderate, both the expert testimony and the evidence relating to the negotiations between the parties, in favor of the interpretation that cost of production was intended to mean what it ordinarily means, and that is the cost of producing a product. Counsel argues, "If you quit making gypsum, your overhead expense would go on anyway. [53] Therefore it is not a proper item to include." This same argument could be applied to the plaintiff's own operations. Your Honor will recall that the plaintiff's witnesses testified that they have a plant at Gerlach. They make four articles down there. Everyone was agreed that in determining the cost of those articles you include the overhead, for whatever purpose, and still it is undeniable that if they discontinued the production of one of those items their overhead would go on just the same. That does not detract from the propriety of the charge. It is still good accounting, and when Jackson says in determining whether it is economic to produce a by-product you figure only the direct cost, that is an expediency. That is for a particular

purpose. If you are making ten articles you are going to decide whether you are going to make the eleventh. Certainly a man would take a pencil and figure out how much it will cost him to make the eleventh. But if he has a contract to sell the eleventh product, when he starts to make it, and the contract says he is entitled to a price which is related to his cost of production, he is going to include all of his cost, and this business about those undeniable principles being inapplicable because somebody else is affected is, in my opinion, simply ridiculous. That is all the more reason for applying sound accounting methods. Sure, if I am operating a factory and I am making a number of products and for my own purpose, to satisfy my own curiosity or for my own business [54] reasons, I can set up my books of account on any basis I want. It may be more economical not to bother with overhead and things of that sort. But where you have a contract that says that your price is related to your cost, then you must include everything. And counsel states that their expert says that that is a reason for excluding overhead. Well, that was presumptuous of them if they did say that. That is not a matter of expert testimony. But the fact of the matter is that I asked Mr. Pryor, who was one of their experts, whether his opinions were influenced in any respect by the consideration that somebody else was affected and whether accounting principles changed according to whether somebody else is affected or not, and he said, "Certainly not." Anybody would have to answer that question that way. Do you want the reference to that, counsel?

Mr. Bennett: Yes, I would.

Mr. Rosenberg: I guess I could find a contrary statement from every expert you put on the stand.

Mr. Bennett: No, I am talking about Pryor's testimony.

Mr. Rosenberg: 634, line 24, where I was asking about overhead.

He said, "What do you mean by overhead?" I said, "You have been using the term for a day. What do you mean by it?" So he told me what he meant by it and I said, "I will use it in that sense." [55]

So I said, "Using it in that sense, you will concede in respect to joint products, co-products or by-products, overhead expense is properly included in determining cost of productions?"

"A. Manufacturing overhead, yes.

"Q. And that is true whether the manufacturer has a contract to sell that product to somebody and the price is to be determined according to the cost of production or not, isn't that true?"

"A. That is right.

"Q. And so the contract and the fact that a certain party might be affected has nothing to do with it, does it?"

"A. Not as far as by-product accounting is concerned."

Mr. Bennett: What page are you reading from?

Mr. Rosenberg: 634 and 635. Also, I would like to comment briefly on counsel's statement regarding their offers to arbitrate. I have always understood, in the first place, that any negotiations to-

wards settlement are inadmissible, in litigation between the parties. I am sure that is the rule. That was jockeyed into the case obviously for the purpose that counsel is now attempting to use it. I submit it is highly improper. It borders on being unethical to do that. But it is in the record, so let us consider there were efforts to negotiate an arbitration. There weren't all the particulars testified to that counsel mentioned. There is no evidence in the record that somebody said, "You name one, we will name one, [56] and let them name a third," and all that business. There is evidence in the record that there were efforts toward arbitration. So what? What does that mean? If I have a 25-year contract to sell a substantial quantity of a manufactured product, and I know that when I negotiated that contract, I told them I would not limit myself to direct cost and the contractual language was changed, and then the other fellow comes along and says, "I don't want to pay you any overhead but I will arbitrate it with you,"—that does not place me under any obligation. There is no untoward inference to be drawn from the fact that I refuse to arbitrate anything as basic as that. That is the lifeblood of this contract perhaps, and why should I arbitrate something as basic as that? And furthermore, if I am going to arbitrate, I would rather have somebody like Your Honor sitting in on the arbitration rather than some accountant. We had a pretty good display here as to what occurs between accountants. I have had experience with a lot of professional witnesses, engineers and account-

ants and it is a pretty dangerous process to have two strangers select a judge for you. I know the judge I am coming before here and I do not like arbitrations, and furthermore, I won't voluntarily arbitrate anything that I consider basic and vital to me and where I figure the attack is completely unjustified. I would rather take my chances in court as we are doing here, Your Honor.

Counsel mentioned again on his argument that you must [57] attach a label. The label "by-product" has been attached to this gypsum by a recitation in the contract, and therefore you can't prove a fact to the contrary. And he says Dr. Seaton admitted it was a by-product. So he pulls out an article written in 1931 by Dr. Seaton. This plant was not even constructed until 1937 and I imagine there was a lot of things that happened in those six years. We were operating pilot plants and experiments. We were submitting samples to the Pacific Portland Cement Company to see if we had a merchantable product before we went to the expense of constructing a substantial plant there. I do not care what Dr. Seaton said in 1931 and I don't care what that little recitation in the contract is. I think the fact controls, if it is a material fact, but it is not even a material fact. They say the contract price of \$2.80 was premised on the direct cost of production at that time. There is testimony to that effect. But you can't beat your head against a brick wall. How could there be cost of production in a plant that was not constructed until a year after this contract was executed? That is just seiz-

ing on little words and making capital of them contrary to what is acknowledged to be the fact.

In several places in the brief, if the Court please, the statement is made that none of the cases that were mentioned relate to a by-product. So here again is that mystical distinction between gypsum and any other product that is made in a plant, by a plant, and with labor because that label is [58] attached. But the fact is there in a California Supreme Court decision that we have cited in our brief that relates to a by-product, and it comes about as close to their own expert's definition of a by-product that you could possibly come and that is the case of *Meyers v. The Texas Company*, where the issue in controversy was the cost of extracting gasoline from a natural gas well, and the Court held that it included items that come within the category of overhead expense, like taxes, insurance and overhead, and here is what the Court says:

“The lease did not obligate the defendant to extract gasoline from the natural gas but provided that if it did lessee should pay lessor one-sixth of the proceeds after deducting the cost of extraction. It is immediately to be observed, therefore, that the possible extraction of gasoline was only an incident to the main undertaking and separate and apart therefrom, presumably dependent upon whether under the circumstances of the production of natural gas, its quantity and quality and the cost of extraction, it could be made profitable for all parties.”

If that is not a by-product, even according to their own expert testimony, then I do not know

what is: "purely incidental." And still the California Supreme Court says under a contract which required the determination of the cost, you include the same type of expenses that we claim must be included in this case. [59]

Now, the inconsistency of the arguments that have been made are almost appalling, if Your Honor please. The plaintiff argues this is a by-product because you can either make it or you do not have to make it, as you see fit. In one breath they argue at another point—I think it is page 16 of their reply brief—well, all this stuff about the cancellation clause is just a bunch of foolishness because they have in effect a cancellation clause and they can stop producing gypsum any time they want. In one breath they say we can't help but make it, and in the next breath they say we have what is equivalent to a cancelation clause. That would be little consolation to us if it were true. That is not tantamount to a cancellation privilege. The fact that we discontinued making a product for which we constructed the plant, if we canceled the contract, we can go on making the product and sell it to anybody we want—I didn't interrupt you, Mr. Bennett, and you said so many things that I disagreed with.

Mr. Bennett: You misquoted me.

Mr. Rosenberg: I don't think I am. I am just going to touch briefly on a couple of more points, Your Honor. The question of sampling is not terribly important but there is nothing in the contract pertaining to sampling. What counsel is asking the Court to do now is not to interpret the

contract, but to inject something into the contract that they feel should be in here, and our practice has been recently to give them a [60] composite weekly sample of this gypsum, which is a bulk product, and which when it gets into their plant they put in bins and store up to 500 tons of it at a time; so it is fungible goods. Why should it be sampled or tested on a car basis rather than weekly composite? That gives a fair criterion of what they are getting. And the ironical part of it they say we should sample and test every carload that goes out, and so one of the items that they attack most strongly among our items of overhead expense is our laboratory expense where we do the testing of the gypsum for the purpose of this contract. So in one breath they say, "Sample every car for us," and in the next breath they say, "You should not include that expense in there. That is wrong." How could they consistently maintain positions like that? They would have the Court to believe in their brief that this research that appears on the figures we presented to them is new products research. It is not anything of the kind. In that Exhibit 18 new products research and general laboratory expenses are combined in one figure, and the evidence is uncontradicted that that laboratory expense includes the expense of testing, analyzing gypsum, working out improvement in the process and all these other things that are done in the normal operation of a chemical plant.

One other thing is this sulphuric acid matter. The plaintiff would have the Court understand that

this is a new charge that results from a change in accounting practice that [61] was done for the purpose of loading this contract. There have been a lot of inferences of that kind but no proof. The fact of the matter is it is not. It is a charge which results from a change in basic operating conditions in the plant. I asked two of their own witnesses the question:

“If you have a charge which appears for the first time by reason of a change in circumstances, that is a proper charge?”

And this sulphuric acid does result from a change of circumstances. We formerly manufactured bromine, and we discontinued bromine, and from the time we discontinued bromine we are only making two products, gypsum and magnesium oxide, and the evidence is uncontradicted that the sulphuric acid is necessary to the manufacture of gypsum and it is not necessary to the manufacture of magnesium oxide, and we quoted in our brief the testimony of our chemist who conducted this test, where they tried to make gypsum without sulphuric acid into bittern. They ran a test for four days and he said the crystals were of such composition that it clogged the filtering machine and made the drawing processes extremely difficult. And so I said in my brief the testimony was that the gypsum that was produced without the use of sulphuric acid was unsatisfactory, and counsel took me to issue on that and said there is no evidence to that effect. I submit if you produce a product that you can not process without gumming up your machinery, [62]

it is unsatisfactory, and that is what the evidence was. They state now their expert chemist said you have to use sulphuric acid to make magnesium oxide. The evidence is uncontradicted that during the time we were conducting this experiment for four days and not using any sulphuric acid we made magnesium oxide. We sold it. We got no complaints, and it was perfectly satisfactory. So the evidence is undeniable that the sulphuric acid, from the time the manufacturer of bromine was discontinued, was necessary to the production of gypsum and the production of gypsum only, that the charge occurred not from a change in accounting methods but from a change in basic conditions in the plant, according to their own expert witnesses, and therefore the charge is proper.

I would like to go into some of the other items, our Honor, but time will not permit. I just want to mention one other thing and that is these figures we presented to the plaintiff, and I think the Court will remember them pretty well. Those figures were presented as a courtesy by us because they did not want to go to the expense of preparing them. We prepared them in the form that they asked for them. They would imply we are attacking our own figures. We are not attacking our own figures. We will vouch for the integrity of those figures. But they are attempting to use those figures and to disregard circumstances under which they were prepared and the explanation which was affixed to them when they were furnished. [63] That is what we object to.

Just one other thing. The burden of proof we have argued fully, Your Honor. The cases are completely in accord with our contention.

The Court: You have five minutes more.

Mr. Rosenberg: Where a plaintiff comes in and files a suit for declaratory relief, he has the burden of proving the allegations of his complaint, and in this complaint the plaintiff comes into this court and alleges that our cost did not increase more than so many cents per ton in one period and so many cents per ton in another period, and therefore the burden is upon them to prove the allegations of their complaint, and there just can not be any question about that. Counsel would argue that they could come in there and file this suit and come into court and say, "Good morning, Judge," sit down and we would have to go ahead and prove the case. One of the criteria that the case is set forth for determining who has the burden of proof is "Against whom?" Should a judgment be rendered if no evidence were produced? And if they came into this courtroom and sat down at that table and were mute, certainly there would not be any judgment in their favor. They say in our answer they have alleged that our costs did not increase, and we have said that they did and therefore that is our affirmative allegation that we must prove. That is ridiculous. Those affirmative allegations are merely the denials of a negative allegation, [64] and the fact of there being a negative allegation does not place any burden on us. And I might say certainly their contention now is utterly inconsistent with their con-

duct during their trial. I sat for eight days waiting for them to put a witness on, and if they were not assuming the burden of proof I do not know what they were doing.

“When an issue of fact is tendered by the complaint and denied by the answer, the plaintiff must prove the complaint even though it is a complaint for declaratory judgment.”

Here is what a federal court said in an insurance case. An insurance company comes into federal court on an accident policy and asks for a declaratory judgment that the beneficiary is not entitled to recover because the insured died from natural causes rather than an accident—in other words, asked for a negative judgment on a negative allegation. If they had sat back and waited for the beneficiary to file suit, the beneficiary would have had the burden of proof that the insured died from accident. But the insurance company jumped the gun and filed the suit, came into court, and then they wanted, just as the plaintiff does in this case, to cast the burden on the defendant, and this is what the Court said. This is a federal case. “Asking a judgment that it is not liable, it, the plaintiff, must prove it is not liable. Non-liability is one of the rights referred to in the act. Certainly the declarant must plead in his petition, **declaration or** complaint the facts which [65] entitle him to the judgment he seeks. What he pleads he must prove.”

Here they pleaded our costs did not increase and they must prove it, and I submit that they did not, if the Court please.

I just repeat: The contract should be declared void for uncertainty. If the Court thinks otherwise, there can not be any question but what the weight of evidence is in favor of inclusion of overhead and indirect costs.

Mr. Bennett: Your Honor has a 2:00 o'clock trial date. It will take me some time, and there are many things that counsel has said that I would like to reply to, and I hope in not doing it, Your Honor will not think for a moment that I accede to the truth or the validity of his contentions.

There is just one thing I want to mention. He has tried to make it appear that Your Honor should disregard the contemporaneous construction of the contract, which I say is separately one of the three reasons why the plaintiff's construction of this contract must be upheld. He would lead the Court to believe that in 1941 when his first price raise was made that we were told all about the inclusion of overhead. Obviously this letter that we introduced in evidence, of October 2, 1941, must show the contrary.

The Court: Limiting it to that letter, but that is not all the testimony. [66]

Mr. Bennett: The testimony is we went down and had a visit with them.

The Court: Yes.

Mr. Bennett: But Mr. Colton said he was not told at that time or any other time that there was any inclusion of overhead or indirect costs, and the man who wrote this letter is within this district, within thirty miles of this court. He could have

been brought as a witness. He was the accountant down there who wrote this letter, and if Mr. Colton or Mr. Camden had been told or shown that there had been any inclusion of overhead or indirect costs in that first price raise, they would have brought him. This letter says, "We have analyzed gypsum production costs for the years ending so-and-so," "We are attaching a recapitulation of labor, material and power costs, which account for 15 cents of the 18 cents a ton increase." What could be clearer and plainer to a person receiving that letter that these people were basing that first price increase solely on direct costs? If there had been any intention or any evidence or any fact that Mr. Camden or Mr. Colton had been otherwise advised, they would have brought Mr. Hurlbert here and he would have given that sort of evidence.

Mr. Rosenberg: That is the first time since this contract has been in effect that this plaintiff has been so magnanimous that a matter of three cents makes any difference to them. They are taking fractional deductions from our bills [67] where the contract only entitles them to full percentages, and they are questioning every penny or fractional penny, and I think it is reasonable to assume from their contract, their conduct, that if they did not know what those three cents were, they would have found out about it.

The Court: The matter is submitted gentlemen.

CERTIFICATE OF REPORTER

I, J. J. Sweeney, Official Reporter, certify that the foregoing 68 pages is a true and correct transcript of the matter therein contained as reported

by me and thereafter reduced to typewriting, to the best of my ability.

/s/ J. J. SWEENEY.

[Endorsed]: Filed March 2, 1948.

[Endorsed]: No. 12054. United States Court of Appeals for the Ninth Circuit. Pacific Portland Cement Company, a corporation, Appellant, vs. Westvaco Chlorine Products Corporation, a corporation, Appellee. Transcript of the Record. Appeal from the District Court of the United States for the Northern District of California, Southern Division.

Filed September 30, 1948.

/s/ PAUL P. O'BRIEN,

Clerk of the United States Court of Appeals for the Ninth Circuit.

In the United States Circuit Court of Appeals
for the Ninth Circuit

No. 12054

PACIFIC PORTLAND CEMENT COMPANY, a
California, Corporation.

Appellant,

vs.

WESTVACO CHLORINE PRODUCTS CORPO-
RATION, a Corporation.

Appellee.

APPLICATION FOR AN EXTENSION OF
TIME TO FILE RECORD ON APPEAL AND
DOCKET APPEAL

Pacific Portland Cement Company, plaintiff and

appellant in an action in the District Court of the United States for the Northern District of California, Southern Division, Civil No. 26934-R therein, filed in said court on May 25, 1948, its notice of appeal to the above-entitled court from a judgment entered April 26, 1948. On July 1, 1948, said District Court made its order extending the time for filing the record on appeal in the above-entitled court and for docketing the appeal therein to and including August 23, 1948.

Said appellant hereby makes application to the above-entitled court for an extension of time for said purposes to and including September 30, 1948. Said application is made upon the ground that the record in the action is very voluminous and the added time is necessary for counsel and for the clerk of the district court to prepare the record for filing in this court. Said application is based upon the stipulation of the parties and the affidavit filed herewith.

Submitted therewith is the form of order sought by the appellant.

Dated: San Francisco, California, August 13, 1948.

Respectfully submitted,

/s/ PILLSBURY, MADISON &
SUTRO,

/s/ EUGENE D. BENNETT,
/s/ FRANCIS R. KIRKHAM,
/s/ WALLACE L. KAAPCKE,
Attorneys for Appellant.

(Receipt of Copy.)

[Endorsed]: Filed August 14, 1948. Paul P. O'Brien, Clerk.

[Title of U. S. Court of Appeals and Cause.]

STIPULATION FOR EXTENSION OF TIME
FOR FILING RECORD ON APPEAL AND
DOCKETING APPEAL

It is hereby stipulated by the parties hereto that the time for filing in the above-entitled court the record on appeal and for docketing the appeal in said court may be extended to and including September 30, 1948, subject to the entry of an appropriate order, to which consent is hereby given.

Dated: August 13, 1948.

/s/ PILLSBURY, MADISON &
SUTRO,

/s/ EUGENE D. BENNETT,

/s/ FRANCIS R. KIRKHAM,

/s/ WALLACE L. KAAPCKE,

Attorneys for Appellant.

/s/ BACIGALUPI, ELKUS &

SALINGER,

/s/ CLAUDE N. ROSENBERG,

/s/ TADINI BACIGALUPI,

Attorneys for Appellee.

[Endorsed]: Filed August 14, 1948. Paul P. O'Brien, Clerk.

[Title of U. S. Court of Appeals and Cause.]

AFFIDAVIT IN SUPPORT OF APPLICATION FOR EXTENSION OF TIME TO FILE RECORD ON APPEAL AND TO DOCKET APPEAL

Wallace L. Kaapeke, being first duly sworn, deposes and says that:

He is an attorney admitted to practice in the above-entitled court and is one of the attorneys for the appellant in this cause. In said cause (the action bearing Civil No. 26934-R in the District Court of the United States for the Northern District of California, Southern Division) judgment was entered April 26, 1948, and appellant filed its notice of appeal to this court on May 25, 1948. On July 1, 1948, said District Court made its order extending the time for filing in this court the record on appeal and for docketing the appeal herein, to and including August 23, 1948.

The record in the case is very voluminous, the transcript of the proceedings at the trial comprising 1230 pages, and there being other voluminous documents contained in the record. The case is of a technical accounting and chemical nature, and due to the technical nature of the testimony, a great number of corrections in the transcript have been necessary. Counsel for both parties have now been able to agree upon the corrections to be made, but affiant is informed that a substantial period will be required for the reporter to make the corrections. Affiant is further informed that the clerk of the Dis-

trict Court of the United States for the Northern District of California, Southern Division, requires further time for preparation of the record on appeal and will welcome an extension of time to September 30, 1948. Counsel for the appellant also need that period of time within which to complete their study of the record, their determination of the portions thereof to be printed, and their preparation of the statement of points intended to be relied upon on appeal.

/s/ WALLACE L. KAAPCKE.

Subscribed and sworn to before me this 13th day of August, 1948.

[Seal] /s/ ALICE E. LOWRIE,
Notary Public in and for the City and County of
San Francisco, State of California.

[Endorsed]: Filed August 14, 1948. Paul P.
O'Brien, Clerk.

[Title of U. S. Court of Appeals and Cause.]

ORDER EXTENDING TIME TO FILE RECORD
ON APPEAL AND TO DOCKET APPEAL

Upon the application of appellant, Pacific Portland Cement Company, and the stipulation and affidavit filed therewith, and good cause appearing therefor, it is hereby Ordered that the time for filing in this court the record in the above-entitled cause (the action bearing Civil No. 26934-R in the District Court of the United States for the Northern District of California, Southern Division), and the time for docketing the appeal herein, be and it is hereby extended to and including September 30, 1948.

Dated: August 13, 1948.

/s/ WILLIAM DENMAN,
Senior Circuit Judge.

[Endorsed]: Filed August 14, 1948. Paul P. O'Brien, Clerk.

[Title of U. S. Court of Appeals and Cause.]

STATEMENT OF POINTS ON WHICH
APPELLANT INTENDS TO RELY

Appellant, Pacific Portland Cement Company, makes the following statement of the points on which it intends to rely upon the appeal herein:

1. The trial court erred in declaring that the terms "cost of production" and "cost of manufacture" as used in paragraph (6) of the contract between the parties dated January 29, 1937, are not

limited to actual or direct costs, and in declaring that said terms include overhead expense and indirect charges which cannot be directly charged to or against each of the various products produced by appellee at its Newark, California, plant, in that each of said declarations is contrary to said contract, is unsupported by the evidence, and is contrary to the law applicable thereto.

2. The trial court erred in declaring that appellee's cost of production of gypsum as determined by appellee from time to time and the resultant increases in price established by appellee from time to time have been in accordance with the terms and provisions of said contract, in that said declaration is contrary to said contract, is unsupported by the evidence, and is contrary to the law applicable thereto.

3. The court erred in declaring that appellee's cost of production of gypsum for the period July 1, 1939, to June 30, 1940, was \$1.66 per ton, or any amount in excess of \$.85 per ton, and in declaring that appellee's cost of production for the period July 1, 1940, to June 30, 1941, was \$1.84 per ton, or any amount in excess of \$.93 per ton, in that each of said declarations is contrary to the contract, is unsupported by the evidence, and is contrary to the law applicable thereto.

4. The trial court erred in declaring that on September 4, 1946, appellee became entitled under the contract to an increase of \$.78 per ton (from \$2.98 to \$3.76) in the price of gypsum sold to appellant, by reason of an increase of \$.78 per ton in appel-

lee's cost of production of gypsum. Said declaration is contrary to the contract, is unsupported by the evidence, and is contrary to the law applicable thereto to the extent of any increase in appellee's cost of production and resultant increase in the price in excess of \$.29 per ton. The difference of \$.49 per ton is made up of the following items charged by appellee to the cost of production of gypsum, in the allowance of each of which the court erred, for the reasons above set forth:

(a) An increase of \$.12 per ton due to appellee's charging expense for "new products research";

(b) An increase of \$.05 per ton due to appellee's charging expenses of its west coast operations of a general and administrative nature;

(c) An increase of \$.32 per ton due to appellee's charging other overhead expenses and indirect charges.

5. The trial court erred in declaring that on November 13, 1946, appellee became entitled under the contract to an increase of \$.60 per ton (from \$3.76 to \$4.36) in the price of gypsum sold to appellant, by reason of an increase of \$.60 per ton in appellee's cost of production of gypsum. Said declaration is contrary to the contract, is unsupported by the evidence, and is contrary to the law applicable thereto, to the extent of any increase in appellee's cost of production and resultant increase in the price in excess of \$.25 per ton and to the extent of any increased price in excess of \$3.52 per ton. The difference of \$.35 per ton is made up of the following items charged by appellee to the cost

of production of gypsum, in the allowance of each of which the court erred, for the reasons above set forth:

(a) Increases of \$.03 per ton due to appellee's charging indirect shipping expense and the cost of use of an air compressor and due to appellee's failure to apply consistent accounting methods in the two cost periods compared with respect to indirect shipping expense and the cost of use of an air compressor;

(b) An increase of \$.23 per ton due to appellee's charging the cost of sulphuric acid and due to appellee's failure to apply consistent accounting methods in the two cost periods compared with respect to the cost of sulphuric acid;

(c) An increase of \$.06 per ton due to appellee's charging expenses of its west coast operations of a general and administrative nature;

(d) An increase of \$.03 per ton due to appellee's charging other overhead expenses and indirect charges.

6. The court erred in declaring that for the purpose of analyzing gypsum sold to appellant to determine its conformity or non-conformity to the specifications of the contract, a composite sample of the aggregate quantity of gypsum shipped to appellant in a 24-hour day affords a fair and proper criterion of the gypsum delivered, and in declaring that such method of sampling is in accordance

with the terms and provisions of the contract. Each of said declarations is contrary to the contract, is unsupported by the evidence, and is contrary to the law applicable thereto.

7. The court erred in declaring that under paragraph (5) of the contract plaintiff is entitled, in the event the gypsum content of gypsum sold to appellant falls below 95.51%, to deduct from the contract price of such gypsum the amount of \$.10 per ton only for each full percentage by which the gypsum content falls below 97.51%, and that plaintiff is not entitled to deduct fractions of \$.10 per ton on account of fractions of a full percentage in gypsum deficiency. Said declaration is contrary to the contract and to the law applicable thereto.

8. The trial court erred in holding that appellant had the burden of proof to establish that the price increases claimed by appellee were unjustified. Said holding is contrary to the law, for the reason that appellee has the affirmative of the issue whether its cost of production of gypsum had in fact increased as asserted by defendant, and consequently appellee had the burden of proof to establish that the price increases claimed by it were justified.

9. The trial court erred in declaring that plaintiff is not entitled to judgment against defendant for the sum of \$9,405.93 or any other sum.

10. The trial court erred in adjudging that the respective parties should pay their own costs.

Dated: San Francisco, California, the 11th day of October, 1948.

/s/ PILLSBURY, MADISON &
SUTRO,

/s/ EUGENE D. BENNETT,

/s/ FRANCIS R. KIRKHAM,

/s/ W. L. KAAPCKE,

Attorneys for Appellant.

[Endorsed]: Filed October 12, 1948. Paul P. O'Brien, Clerk.

[Title of U. S. Court of Appeals and Cause.]

STIPULATION FOR CONSIDERATION OF EXHIBITS IN ORIGINAL FORM

Pacific Portland Cement Company, Appellant, and Westvaco Chlorine Products Corporation, Appellee, hereby stipulate that Plaintiff's exhibit 16 and Defendant's exhibit I, included in item 24 of the Designation of Parts of Record Necessary for Consideration filed herein by Appellant, need not be printed as part of the record, but may be considered in their original form, and in such form shall constitute a part of the record on appeal. Plaintiff's exhibit 16 consists of a large chart, and Defendant's exhibit I consists of photographs, and neither of said exhibits can feasibly be reproduced by printing. This stipulation is made without prejudice to the right of Appellee to designate ad-

ditional parts of the record which Appellee thinks material.

Dated: San Francisco, California, the 8th day of October, 1948.

s/ PILLSBURY, MADISON &
SUTRO,

/s/ EUGENE D. BENNETT,

/s/ FRANCIS R. KIRKHAM,

/s/ WALLACE L. KAAPCKE,
Attorneys for Appellant.

s/ BACIGALUPI, ELKUS &
SALINGER,

/s/ CLAUDE N. ROSENBERG,

/s/ TADINI BACIGALUPI,
Attorneys for Appellee.

[Title of U. S. Court of Appeals and Cause.]

ORDER FOR CONSIDERATION OF
EXHIBITS IN ORIGINAL FORM

Upon the stipulation of Appellant and Appellee on file herein and good cause appearing therefor, it is hereby ordered that Plaintiff's exhibit 16 and Defendant's exhibit I need not be printed as part of the record, but may be considered in their original form, and in such form shall constitute a part of the record on appeal.

Dated: San Francisco, California, the 11th day of October, 1948.

/s/ WILLIAM DENMAN,
Chief Judge, U. S. Court of Appeals for the Ninth
Circuit.

[Endorsed]: Filed October 12, 1948. Paul P.
O'Brien, Clerk.

[Title of U. S. Court of Appeals and Cause.]

DESIGNATION OF PARTS OF RECORD
NECESSARY FOR CONSIDERATION

Pacific Portland Cement Company, appellant herein, designates the following parts of the record as necessary for the consideration of the points relied on:

1. Complaint, page 1 to page 11;
2. Motion and Notice of Motion for Order for Deposit in Court, together with Memorandum of Points and Authorities, and Order Shortening Time for Hearing of Said Motion, page 12 to page 17;
3. Order for Deposit in Court dated March 14, 1947, page 18;
4. Answer, page 19 to page 30;
5. Plaintiff's Reply to Counterclaims, page 31 to page 32;

(Here are omitted the following:

- a. Interrogations Propounded to Defendant, and Answers thereto, page 33 to page 60;
- b. Motion and Notice of Motion for Order Compelling Further Answers to Interrogations, page 61 to page 69;
- c. Motion and Notice of Motion for Production, Inspection and Copying of Documents, page 70 to page 76.)
6. Order for Refund out of Deposit in Court and for Reduction of Further Deposits, dated September 19, 1947, page 77 to page 78;
7. Amendment to Plaintiff's Reply to Counterclaims, page 79 to page 80;

(Here are omitted the following:

a. Motion and Notice of Motion for Production, Inspection and Copying of Document, page 81 to page 84.

b. Order for Production, Inspection and Copying of Documents, page 85 to page 86.

c. Notice to Produce Original Documents, page 87 to page 88.

8. Stipulation for Compromise and Dismissal of Defendant's First Counterclaim, page 89 to page 90;

9. Order for Entry of Judgment, dated March 30, 1948, page 91 to page 92;

(Here are omitted the following:

a. Motion and Notice of Motion for Order Terminating "Order for Deposit in Court" and for Payment to Defendant of Money on Deposit, page 93 to page 96. Said motion was disposed of by the stipulation and order designated herein as item 12;

b. The proposed findings of facts and drafts of judgment submitted by the parties, and objections thereto and proposed modifications and amendments thereof, page 97 to page 139.)

10. Findings of Fact and Conclusions of Law, page 145 to page 157;

11. Judgment, page 158 to page 161;

12. Stipulation and Order re Payments under Contract and re Stay of Judgment, page 140 to page 144;

13. Memorandum Opinion, dated May 3, 1948, page 162 to page 168;

14. Notice of Appeal with date of filing, page 169 to page 171;

15. Bond for Costs on Appeal, page 172 to page 173;

16. Designation of Contents of Record on Appeal (District Court), page 174 to page 177.

17. Stipulation for Transmittal of Original Exhibits, page 178 to page 179;

18. Order under Rule 73(g) Extending Time for Filing Record on Appeal and Docketing Action, page 180 to page 181;

19. Order Extending Time to File Record on Appeal and to Docket Appeal (by Circuit Court of Appeals), page 182;

20. Clerk's Certificate, page 183;

21. Statement of Points Intended to Be Relied on on Appeal;

22. Designation of Parts of Record Necessary for Consideration;

23. All of the Reporter's Transcript except the following portions thereof, consisting of arguments and statements of counsel, (the page and line references following are to page and line as enumerated in the Reporter's Transcript):

a. Page 2, line 1, to page 26, line 11;

b. Page 27, line 1, to page 43, line 16;

c. Page 114, line 25, to page 132, line 16.

24. The following exhibits marked for identification or received in evidence at the trial of the cause:

a. Plaintiff's exhibits 1 to 20, both inclusive;

b. Defendant's exhibits A to M, both inclusive;
(The depositions of Stanley H. Barrows,

James H. Colton, and L. O. Bannard, are omitted.)

25. Stipulation for Consideration of Exhibits in Original Form;

26. Order for Consideration of Exhibits in Original Form.

Dated: San Francisco, California, the 8th day of October, 1948.

/s/ PILLSBURY, MADISON &
SUTRO,

/s/ EUGENE D. BENNETT,

/s/ FRANCIS R. KIRKHAM,

/s/ WALLACE L. KAAPCKE,

Attorneys for Appellant.

[Endorsed]: Filed October 12, 1948. Paul P. O'Brien, Clerk.

No. 12,054

IN THE
United States Court of Appeals
For the Ninth Circuit

PACIFIC PORTLAND CEMENT COMPANY,
a corporation,

Appellant,

vs.

WESTVACO CHLORINE PRODUCTS CORPORA-
TION, a corporation,

Appellee.

APPELLANT'S OPENING BRIEF.

MARSHALL P. MADISON,
EUGENE D. BENNETT,
FRANCIS R. KIRKHAM,
WALLACE L. KAAPCKE,

Standard Oil Building, San Francisco 4, California,
Attorneys for Appellant.

PILLSBURY, MADISON & SUTRO,

Standard Oil Building, San Francisco 4, California,
Of Counsel.

FILED

MAR 21 1949

PAUL P. O'BRIEN.

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No. 12,054

IN THE

**United States Court of Appeals
For the Ninth Circuit**

PACIFIC PORTLAND CEMENT COMPANY,
a corporation,

Appellant,

vs.

WESTVACO CHLORINE PRODUCTS CORPORA-
TION, a corporation,

Appellee.

APPELLANT'S OPENING BRIEF.

OPINION BELOW.

The opinion of the district court (R. 67) is reported at 77 F. Supp. 406.

STATEMENT AS TO JURISDICTION.

This is a suit for declaratory and other relief brought under 28 U.S.C. § 400 (now 28 U.S.C. § 2201) by appellant, a California corporation (R. 2, 48), against appellee, a Delaware corporation (R. 2, 48). The complaint alleged (R. 3) and the answer admitted (R. 18) the existence of a controversy regarding the provisions of a contract between the parties, and that the value of the matter in-

volved in the suit is in excess of \$3,000, exclusive of interest and costs (R. 2, 18). The district court found these facts to be true (R. 48, 49, 50). The complaint prayed, *inter alia*, judgment against appellee in the amount of \$9,405.93 (R. 7). A declaratory judgment was entered April 26, 1948 (R. 63-66), timely notice of appeal was filed May 25, 1948 (R. 74-77), and the appeal was duly perfected (R. 83, 84, 85, 1314, 1319).

The district court had jurisdiction under 28 U.S.C. § 400 (now 28 U.S.C. § 2201) and 28 U.S.C. § 41(1) (now 28 U.S.C. § 1332(a)(1)). This court has jurisdiction under 28 U.S.C. § 225(a) (now 28 U.S.C. § 1291). The pleadings necessary to show the existence of the jurisdictions are the complaint (R. 2-13) and the answer (R. 17-34).

STATEMENT OF THE CASE.

In 1936, appellee's predecessor, California Chemical Company, was contemplating the construction at Newark, California, of a chemical manufacturing plant (R. 747, 756, 773), and the plant was constructed during 1937 (R. 743, 744). It was "primarily designed to produce magnesium oxide in its various forms," and would "produce as a by-product substantial quantities of gypsum" (Def. Ex. G, R. 750, 751). Seeking a market for this by-product (R. 773), appellee's predecessor approached appellant (R. 773) and the ensuing negotiations (R. 756) resulted in a contract dated January 29, 1937 (Def. Ex. G, R. 750). This contract provides for the sale by appellee and the purchase by appellant of "the entire output of by-product gypsum" produced at the plant in excess of certain limited require-

ments of the seller (R. 751). Its term is to January 31, 1962, subject to appellant's right to terminate it upon giving one year's notice of termination to the seller (R. 752). Almost immediately upon the execution of the contract appellee Westvaco acquired the plant and succeeded to all the rights and obligations under the contract of California Chemical Company (R. 748, 771).

Appellant's complaint (R. 2-13) in three counts alleged controversies under the contract, and sought declaratory relief construing its paragraphs (3), (5) and (6) (R. 7). The third count, which involved paragraph (3) of the contract, is not here in issue. The answer admitted the controversies (R. 18) and also sought declaratory relief (R. 33). The answer further pleaded numerous affirmative defenses and three counterclaims, and appellant filed a reply to the counterclaims (R. 34, 35) and an amendment to the reply (R. 37, 38). Excepting the first defense to each of counts one and two (R. 18, 27), these defenses and counterclaims are not in issue upon this appeal.¹

Paragraph (6) of the contract.

The principal dispute concerns paragraph (6), the so-called "escalator" or "price-protection" clause. The contract fixed an initial price of \$2.80 per ton (Def. Ex. G,

¹The affirmative defenses raised the issues of the statute of frauds; that the contract is void for want of consideration, lack of mutuality and uncertainty; that appellant is barred by estoppel, waiver, material breaches, the statute of limitations and laches; and that the complaint does not state a claim upon which relief can be granted (R. 21-27, 28, 29). All of these issues were determined adversely to appellee (R. 48, 49, 58, 63).

The first counterclaim was compromised (R. 39-41, 56), and the issues of material breach raised in the second and third counterclaims (R. 31, 32) were determined adversely to appellee (R. 49). All the counterclaims were dismissed (R. 66).

R. 750, 753) for the by-product gypsum, and then provided in paragraph (6) (R. 754):

“In the event that California’s cost of production of gypsum for any twelve (12) months’ period during the term hereof shall increase five per cent (5%) above its average cost of production of gypsum for the preceding twelve (12) months’ period, then and in that event California shall have the right, upon giving sixty (60) days’ written notice to Pacific, to increase the price payable hereunder for gypsum thereafter delivered hereunder in an amount *not to exceed the actual advance in California’s cost of manufacture*; provided that in no event may more than one such increase be made in any one calendar year.”²

Over the years appellee has claimed three price increases (Plf. Ex. 1, R. 99, 100; Plf. Ex. 2, R. 119, 120, 121; Plf. Ex. 10, R. 220, 221), which altogether would bring the price to \$4.36 per ton (R. 219). Appellant contends that the proper application of paragraph (6) brings the price to not more than \$3.52 per ton, and resists portions of the last two increases which in its view are not authorized.³

Appellee based its first price increase (effective October 5, 1941) upon a claimed increase of 18 cents per ton in the “cost of production of gypsum” for the period July 1, 1940, to June 30, 1941, over such cost for the preceding twelve months, July 1, 1939, to June 30, 1940. This increase brought the initial contract price of \$2.80 per ton to \$2.98

²Italics throughout the brief are ours unless otherwise indicated.

³Since entry of the judgment below, a fourth increase has been claimed of 87 cents per ton, to bring the price to \$5.23. The propriety of a part of this increase will depend upon the final disposition of this case.

(Plf. Ex. 1, R. 99, 100). Under circumstances hereafter related, appellant paid this new price without objection.

The second increase claimed was to become effective March 15, 1944, but remained inoperative because of O.P.A. price control until September 4, 1946 (R. 205, 215). It was based on the higher cost of production for the calendar year 1943 over that for 1942, and was asserted in the amount of 78 cents per ton. This would bring the price of \$2.98 per ton to \$3.76. Appellant promptly protested that appellee had not determined its cost of production of gypsum in these two years in accordance with the contract and that in fact the 1943 cost was only 29 cents per ton over the 1942 costs, bringing the contract price from \$2.98 per ton to \$3.27⁴ (Plf. Ex. 4, R. 151-153).

The third increase, to be effective November 13, 1946, was claimed in the amount of 86 cents per ton, based on an asserted 86-cent per ton increase in the cost of production of gypsum for the period July 1, 1945, to June 30, 1946, over the cost for the preceding twelve months, July 1, 1944, to June 30, 1945. Appellee later reduced this claimed increase to 60 cents per ton. This would bring the asserted price of \$3.76 per ton (including the full

⁴At the trial appellant questioned appellee's methods of charging taxes and insurance on the gypsum portion of the plant. Objection to these items is not urged upon the appeal. The insurance charge increased 1 cent per ton in the period of the second increase and decreased 1 cent per ton in the period of the third increase (R. 565). The proper amount of the second increase is thus 30 cents per ton and the price payable from September 4, 1946, to November 13, 1946, is \$3.28. The later decrease in insurance offsets by 1 cent the amount of the third increase appellant considered proper, making it 24 cents per ton. This leaves the price payable under appellant's views from November 13, 1946, at \$3.52 per ton and leaves the portion of the price presently in dispute at 84 cents per ton.

amount of the second raise) to \$4.36. Again appellant protested that appellee's cost of production for these two periods had not been determined in accordance with the contract and that the further cost increase was only 25 cents per ton (Plf. Ex. 13, R. 232, 234-238, 241-244). This would bring the prior price of \$3.27⁵ (including only the correct amount of the second raise) to \$3.52 per ton.⁶ Thus the price claimed is disputed to the extent of 84 cents per ton, because of appellant's objections to portions of the second and third increases.

That part of the price claimed that is in dispute was paid to appellee under protest up to the time the complaint was filed (Findings of Fact, R. 53, 54), and in addition to declaratory relief the complaint asked a money judgment for these payments amounting to \$9,405.93 (R. 7). Under a stipulated order of the district court, appellee has received and is currently being paid the full price claimed for gypsum delivered after the filing of the complaint, but if it is finally determined herein that lower prices were properly payable, appellee is to refund any overpayments made either before or after the filing of the complaint (R. 43-47). At the time this order was entered on April 26, 1948, the payments made exceeded the amount appellant contends should have been charged by \$37,603.61 (R. 44), in addition to the \$9,405.93 sought to be recovered in the complaint.

The district court held, generally, that appellee had correctly determined its cost of production of gypsum in the several periods in question (R. 63, 64). Appellant contends

⁵See note 4, *supra*.

⁶See note 4, *supra*.

that this ruling is contrary to the contract, to the evidence and to the law applicable thereto and is clearly erroneous in the particulars hereinafter set out. In so ruling, the court held that appellant had the burden of proving that appellee improperly determined the cost of production of gypsum and that the disputed price increases were unjustified (R. 73). Appellant contends that this also was error—that since appellee has the affirmative of the issue whether its costs have increased, and to what extent, appellee has the burden of proving the increases it asserts.

Paragraph (5) of the contract.

The method of sampling by which to determine the conformity to the contract requirements of the gypsum sold is also in question. For nine years, from 1937 to late 1946, the parties based their analyses on a sample of each carload (R. 212, 213, 868), such samples being taken by appellee at its plant and furnished to appellant's laboratory and its own (R. 212). Late in 1946 appellee for the first time refused to furnish carload samples (R. 213) and has since furnished only a composite sample representing a week's production, or approximately twenty carloads (R. 212, 213, 868). The district court determined that a composite sample of the aggregate quantity of gypsum shipped to appellant in a 24-hour day should be used (R. 65, 66). Appellant contends that the court erred in so ruling; that the carload method, consistently followed by the parties for nine years under the contract, is the proper method.⁷

⁷A further controversy under paragraph (5) raised in the court below concerned the method of calculating deductions from price for product deficient in gypsum content (R. 5-6). Appellant does not urge this point on the appeal.

Appellee's Manufacturing Process.

Appellee's plant manufactures magnesium oxide, bromine, and the by-product gypsum. In general, the processes employed are as follows:

(1) The initial raw material, known as "bittern," is the liquid remaining after concerns such as Leslie Salt Company (R. 802) have precipitated the salt from sea water taken from the bay (Plf. Ex. 3, R. 128, 129). The bittern is purchased by appellee from the salt producers under long-term contracts (Plf. Ex. 3, R. 128, 129) and received into storage ponds (R. 802).

(2) The raw bittern has a slight and variable alkalinity, which makes further processing difficult (Plf. Ex. 3, R. 128, 133). Because of this condition, sufficient sulphuric acid to give essential neutrality is added to the bittern as it is withdrawn from the storage ponds into feed ponds (R. 803; Plf. Ex. 3, R. 128, 133).

(3) The neutralized bittern flows to bromine separation towers where bromine is removed (R. 803, 831) and most of the bromine is utilized in the manufacture of a product called ethylene dibromide (R. 948). In September, 1945, production of bromine was temporarily discontinued (R. 1016), and this step in the process eliminated (R. 827, 926).

(4) The neutralized bittern (with the bromine removed when the bromine towers are operating) contains, among other constituents, magnesium chloride and magnesium sulphate (R. 802). In order to utilize the magnesium and produce magnesium oxide, it is necessary to remove the sulphates (R. 818, 820, 821) which would otherwise constitute an impurity and prevent or impede magnesium

oxide production (R. 819, 820). There is therefore added to it another chemical, calcium chloride (R. 820). A chemical reaction occurs, the sulphates being precipitated in combination with the calcium as calcium sulphate with two molecules of water (R. 821). This precipitate is separated (R. 822), dried and ground (R. 946, 947), and constitutes the by-product gypsum that is sold to appellant (R. 821, 946, 947).

(5) After this precipitate is removed, there remains in the bittern magnesium chloride (R. 823). Calcium hydroxide (or the equivalent, quicklime or dolomite) is next added (R. 823, 824), and a further chemical reaction occurs, magnesium hydroxide being precipitated and separated (R. 824). When further processed this precipitate becomes magnesium oxide (R. 824). There remains calcium chloride, which is returned to the step in the process described in paragraph (4), and is there added to new quantities of neutralized bittern coming from the feed ponds or from the bromine towers when they are in operation (R. 804, 824).

Steps (4) and (5) are shown in graphic form on a large chart (Plf. Ex. 16, admitted R. 1244) which by stipulation and order is to be considered in its original form (R. 1324, 1325), and we respectfully refer the court to this chart.

SPECIFICATION OF ERRORS RELIED UPON.

1. The court erred in finding and concluding that appellee's cost of production of gypsum as determined by appellee from time to time and the resultant increases in

price claimed by appellee have been in accordance with the contract in suit, said finding and declaration being contrary to the evidence, to the contract and to the law applicable thereto in each of the particulars hereinafter specified.

2. The court erred in failing to find and conclude that for the purpose of establishing under the contract "the actual advance in [appellee's] cost of manufacture" and the resultant increase in price:

(a) Overhead expense and indirect charges cannot be included in appellee's determination of the cost of production of gypsum;

(b) Expenses totally unrelated to gypsum, in particular expense for "new products research," cannot be included in appellee's determination of the cost of production of gypsum;

(c) Appellee's expenses of a general and administrative nature cannot be included in appellee's determination of the cost of production of gypsum;

(d) Inconsistent accounting methods cannot be employed, in two cost periods being compared, in determining the cost of production of gypsum, and in particular in determining the costs, respectively, of sulphuric acid, indirect shipping expense and the air compressor;

(e) Depreciation expense cannot be increased by a calculation using the "straight line" method when, in the years compared, different quantities of gypsum are produced.

3. The trial court erred in holding that appellant had the burden of proving that the price increases claimed by

appellee were unjustified, said holding being erroneous for the reason that appellee has the affirmative of the issue whether its cost of production of gypsum has in fact increased as asserted by appellee and consequently has the burden of proving that the price increases claimed by it were justified.

4. The trial court erred in finding and concluding that for the purpose of analyzing gypsum sold to appellant to determine its conformity or nonconformity to the specifications of the contract, a composite sample of the aggregate quantity of gypsum shipped to appellant in a 24-hour day affords a fair and proper criterion of the gypsum delivered, and in concluding that such method of sampling is in accordance with the contract, for the reason that said finding and conclusion are contrary to the contract, to the evidence, and to the law applicable thereto, which require determination that a sample of each car-load of gypsum shipped to appellant be used.

5. The court erred in finding and concluding that appellant was not entitled to judgment against appellee for the sum of \$9,405.93.

SUMMARY OF ARGUMENT.

The contract in suit expressly declares that gypsum is a "by-product" produced in a plant "primarily designed to produce magnesium oxide." Paragraph (6) provides that if the cost of production of this by-product gypsum goes up in any 12-month period as compared to the preceding 12 months, the price may go up "in an amount not to exceed the actual advance in [appellee's] cost of manu-

facture." Under these terms, the cost increases upon which price increases may be based are subject to three specific limitations: The increased item of cost must be a cost of *production* as distinguished from an item of cost unrelated to production or manufacture. The increased item of cost must be a cost of producing the *by-product gypsum* as distinguished from an expense unrelated to gypsum. Finally, there is the over-all limitation that the increase may not exceed the "*actual advance*" in appellee's cost of manufacture. Whatever methods of cost accounting appellee employs for its own internal purposes, it is appellee's duty under this contract to limit the price increases it claims to the "*actual advance*" in the cost of *manufacture* of the *by-product gypsum*. Appellee has failed in its contractual duty so to limit its price increases.

(1) It is the meaning of this contract that the "cost of production of gypsum" comprises the "direct" items of cost. These are the items of cost directly attributable to, and identifiable in their relation to, the production of gypsum. Appellee has included in the cost of production "indirect" costs—costs that are unascertainable in their relation to gypsum production and would go on even if no gypsum were produced. The language of the contract dictates the exclusion of these costs. The negotiations of the parties prior to the execution of the contract clearly show that it was their intent to exclude them. Appellee's conduct after the contract was made shows it placed this interpretation upon the contract. The expert accounting testimony shows that of the methods of by-product accounting found in practice, the method required by this

contract is the one which excludes "indirect" costs from the cost of production of the by-product gypsum.

(2) Even if it should be held, contrary to our contention, that all indirect charges are not to be excluded in determining the cost of production of gypsum, nevertheless indirect charges totally unrelated to *gypsum* may not be included. Twelve cents per ton of one price increase was claimed by reason of appellee's charging to gypsum a portion of its expense for "new products research". This expense is not in any way related to gypsum production and even included a project seeking a way to eliminate gypsum production.

(3) In addition, even if all indirect charges are not to be excluded, the contract requires the exclusion of such charges as are not related to *production*. Six cents per ton of one price increase and 5 cents per ton of another were caused by appellee's charging to gypsum a portion of the general and administrative expenses of its west coast operations. The increases in these expenses, which are dissociated from production or manufacture, must be excluded from the price increases.

(4) Two cents per ton of one price increase was caused by appellee's changing the percentage of its indirect shipping expense charged to gypsum; and one cent per ton of the same increase was caused by a change in the percentage of the expense of an air compressor charged to gypsum. There was no actual advance in either cost. The claimed increases were purely fictitious, resulting from the use by appellee of inconsistent accounting methods in the periods compared and must under the contract be excluded from the price increase.

(5) Twenty-three cents per ton of one price increase was caused by appellee's reassignment among its products of the cost of sulphuric acid—a material that from the beginning has always been used and served the same function in gypsum production. Its cost has always been present, and there has been no actual advance in its cost. Under the contract the fictitious increase shown on appellee's books solely by reason of a change in accounting procedure must be excluded from the price increase.

(6) Seven cents per ton of one price increase was claimed because, under the "straight line" method of charging depreciation, one year's diminished production of gypsum created an "accounting" increase in depreciation expense when no actual advance in that expense existed. The contract requires the elimination of this fictitious increase from the price increase.

(7) In every proceeding the burden of proof is upon the party having the affirmative of the issue. This rule applies equally in a suit for declaratory relief even though the party having the affirmative is the nominal defendant. Appellee claimed and pleaded in its answer that cost increases have occurred and that it was entitled to resultant price increases. It has the affirmative of that issue, even though appellant because of the existence of the controversy invoked the jurisdiction of the court as nominal plaintiff. The trial court ruled that appellant had the burden of proving the cost increases had not occurred and the consequent price increases were unjustified; and rested its decision of the whole case upon this conclusion. This fundamental error requires a reversal of the judgment.

(8) The plain language of paragraph (5) of the contract requires that the conformity of each carload of gypsum to the contract specifications be determined. To make that determination, a sample of each carload must be taken for analysis—not a composite sample of the contents of several carloads.

ARGUMENT.

I.

INTRODUCTORY STATEMENT.

Preliminarily, we respectfully emphasize to the court the unusual importance to the parties of the questions involved upon this appeal. The decision of these questions will not only resolve an immediate dispute; it will establish principles of interpreting the contract which will govern the parties for a long remaining contract term as to future price increases appellee may claim. Upon their decision turn the prices applicable to the purchase, over a period of more than sixteen years, of very large annual quantities of gypsum. Production in the last 12-month period shown by the record (the year ending June 30, 1946) was 36,658 tons (R. 565). Upon an annual production of only 30,000 tons, the disputed portion of the price even now claimed would amount to \$25,200 in a year and approximately \$403,200 over the sixteen years. Even small differences in the price cumulatively involve large sums, and in addition, the principles upon which they are made may control in the determination of much larger items.

We wish also to emphasize to the court the practical result of the interpretation of the contract for which appellee contends. The asserted cost of production in the first full year of production under the contract (1938), including all the indirect and other charges appellee would make, was \$2.67 per ton (R. 565). The price was \$2.80, giving appellee a profit of approximately 5 per cent on this by-product. Today, upon a claimed cost of production of \$3.12 (R. 565)—an increase of only 45 cents over the initial asserted cost—appellee claims a price of \$4.36. This increase of \$1.56 over the original price would give appellee a price advance of more than $3\frac{1}{2}$ times the advance in the cost it asserts, and a profit of approximately 40 per cent, or eight times the initial profit.⁸ Surely, the reasonable business men who negotiated and entered into this contract could not have intended such results as these in providing for price increases “in an amount not to exceed the *actual advance* in [appellee’s] cost of manufacture.” For the reasons hereinafter set forth we submit that the findings of the court on the issues presented upon this appeal are “clearly erroneous”.⁹

⁸These margins of profit are, of course, very much greater when the original and the presently claimed price are related to the direct cost in these periods. The direct cost in this first year of production (1938), including direct shipping expense and taxes, insurance and depreciation on the gypsum portion of the plant, was \$2.11 per ton (R. 565, 573) and the initial mark-up over *direct* cost was 69 cents per ton, or approximately 33 per cent. The present mark-up over present direct costs is many times greater (R. 565, 573).

⁹Rule 52(a), Federal Rules of Civil Procedure.

“A finding is ‘clearly erroneous’ when although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed” (*United States v. Gypsum Co.* (1947) 333 U. S. 364, 395).

Grace Bros., Inc. v. Commissioner of Internal Revenue (9 Cir. 1949, No. 11,976) 49-5 C.C.H. Federal Tax Service, par. 9181.

II.

WHAT APPELLEE MAY DO FOR ITS OWN INTERNAL PURPOSES IN ALLOCATING "INDIRECT" CHARGES IS IMMATERIAL. THE EXPRESS TERMS OF THE CONTRACT, THE DECLARATIONS AND CONDUCT OF THE PARTIES, AND THE ACCOUNTING TESTIMONY, SHOW THESE CHARGES MUST BE EXCLUDED IN DETERMINING THE AMOUNT OF ANY "ACTUAL ADVANCE" IN THE COST OF "MANUFACTURE" OF THE "BY-PRODUCT GYPSUM."

A. The language of the contract and the accounting testimony so show.

The question is how, under paragraph (6) of the contract before the court, the "cost of production of gypsum" and the "actual advance in [appellee's] cost of manufacture" are to be determined. The problem is one of interpreting the instrument, to arrive at what the parties intended for the particular purpose of calculating price increases under this contract. The methods by which appellee determines the "cost of production" of gypsum or any other product for its own internal purposes are not determinative. Whether or not accountants would agree that appellee's methods are appropriate, for its own internal accounting purposes, is of no concern. Appellee is a large national concern with many plants all over the United States (R. 772). It purports to employ a uniform national system of accounting (R. 156, 736, 944, 945), which treats everything as if it were a joint product or a co-product (R. 613). It is entitled to do so, for its own internal purposes. But that uniform national system or any other method of accounting, however widely used, cannot override the intent of the parties to this contract as to the calculation of price increases under it, as that intent is found in the instrument itself and the circumstances under which it was made. That intent, we

submit, is to base price increases on a comparison of the "direct" costs that are actually incurred in the manufacture of gypsum as distinguished from so-called "indirect" costs or general overhead costs. These "direct" costs comprise, in addition to operating and repair labor, Workmen's Compensation and Social Security taxes on the direct labor, operating and repair materials, water, power, gas, fuel oil (R. 567), and direct shipping expense (labor and power required to load the gypsum into railroad cars, and repairs to the loading equipment (R. 573)). They also include taxes and insurance upon, and depreciation of, the portion of appellee's plant that is devoted to gypsum production, if these items are properly calculated (R. 513-515, 650-653).

The terms "direct" cost and "indirect" cost as used by appellant are simply a short-hand mode of distinguishing the costs that are directly incurred in the manufacture of gypsum from those whose relationship to its production cannot be ascertained. In referring to "indirect" charges in this brief, appellant refers to those elements of appellee's cost which appellee admits would still be incurred in appellee's operations if no gypsum were produced (R. 1037), and which admittedly are unascertainable in their relation to gypsum production (R. 1235-1238). These charges include the variety of general overhead items shown on the third page of plaintiff's Exhibit 18 (R. 569), as well as appellee's indirect shipping expense, and the cost of the basic raw material, bittern, a portion of which was allocated to gypsum on a purely arbitrary basis (R. 1031). Charges for "inter-departmental water" and "supervision" complete the list (R. 565). They were all charged to gypsum on a

prorata basis "without any reason as to how or in what way the particular items specifically had to do with gypsum" (R. 1192). Most of these expenses were allocated between appellee's products in proportion to the direct labor charges to the products, although other bases of allocation have been used by appellee (R. 735, 736).

The rationale of the direct cost method was thus explained by Dean J. Hugh Jackson, Dean of the Graduate School of Business at Stanford University (R. 1197):

"But most business men would not include as a charge to that by-product that portion of the general overhead which would go on just the same whether the by-product was produced or not. In other words, that product must stand on its own feet as to whether or not it will pay the organization to produce that product from the time it is split off from the main product * * *" (R. 1203).

"* * * the business would have to determine whether or not, if I may use the figurative expression, they would let the material wash down the sewer or whether they would process it still further, and if they are going to process it still further, then I think that product has got to stand on its own feet and be charged only with the additional expense which would be incurred in the processing of it" (R. 1207).

Much of the record is devoted to the expert testimony of accountants who testified on the abstract issue whether or not their accepted method of cost accounting for the cost of production of a by-product, as distinguished from a main product, or co-product, would include an allocation of indirect expenses, in addition to the costs directly

and identifiably incurred in the processing of the by-product after its separation from the main stream of raw material. On this abstract question there was a divergence of opinion.¹⁰ However, the independent accountants called by appellee recognized that the exclusion of indirect charges from cost of production of a by-product is an accepted and widely practiced method of accounting—indeed, the method most commonly found in practice (Farquhar, R. 1119, 1120; Maxwell, R. 1161-1166). None of these accountants, of course, testified as to the method of determining cost and price advances called for by this particular contract—a question of law for the court.

¹⁰Appellant called four witnesses who testified on this question. In addition to Mr. Flicke, vice president of appellant and a certified public accountant of many years' experience (R. 95, 96, 99), there were Kenneth Pryor, resident partner of Price, Waterhouse & Co. (R. 633, 634), Paul Webster, a partner of Haskins & Sells (R. 493), Walter Draewell of Lybrand, Ross Bros. & Montgomery (R. 621), and J. Hugh Jackson, a man of national stature, seventeen years Dean of the Graduate School of Business at Stanford University, for twenty-eight years a teacher of accounting and cost accounting, past president of the National Association of Cost Accountants and of the American Accounting Association, formerly in charge of all staff training throughout North America for Price, Waterhouse & Co., author of books on accounting, and a practicing cost accountant and consultant (R. 1197, 1200). All of these witnesses testified that, in their opinion, cost accounting for a by-product includes only the direct or actual cost (R. 259, 261, 262; 495, 496; 622; 634, 635; 1202-1204). Appellee called two independent certified public accountants, Mr. Farquhar and Mr. Maxwell. Each testified that, in his opinion, the preferable method of cost accounting for a by-product treats it the same as a main product or co-product (R. 1113, 1146), and assigns to it a portion of the indirect expenses of the manufacturing plant (R. 1111, 1135, 1136). Mr. Alexander of the firm of Peat, Marwick & Mitchell was also called by appellee and testified to the same effect (R. 1175, 1176, 1178), but it was brought out on cross-examination that Mr. Alexander's firm is appellee's regular auditor and that he had collaborated with appellee in the preparation for the trial of this case (R. 1186).

The testimony thus leaves it clear that, while experts might differ as to the preferable method of cost accounting for by-products, all eight expert witnesses who testified, either for appellant or appellee (with the single exception of the interested witness, Alexander) testified as a matter of general accounting principle either that the preferable method of accounting for by-products excludes indirect cost, or that this method is an accepted and widely used method.

Thus all the accounting testimony points up the significance of the contract's language. The contract emphasizes a distinction between gypsum and other products produced by appellee, in its conclusive¹¹ recital that the plant was "primarily designed to produce magnesium oxide" but in the course of this production would produce gypsum "as a by-product" (R. 8). Obviously the parties intended and emphasized by these words that gypsum was to be treated, for all purposes of the contract, as a "by-product" as distinguished from a principal product or co-product. The accounting evidence is that of two methods of by-product accounting, one gives it distinct treatment, and the other treats it as though it were like any other product. If the contractual recital is to have any significance, it must be concluded that the appropriate method under the contract is the one which recognizes the special characteristics of a by-product, not the one which ignores them.

¹¹California Code of Civil Procedure, section 1962, subsection 2:
 "The following presumptions * * * are deemed conclusive:
 * * * * *

2. The truth of the facts recited, from the recital in a written instrument between the parties thereto, or their successors in interest by a subsequent title; * * *."

This is in accord with the entire purpose and plan of the agreement. The record establishes without contradiction that in considering the advisability of constructing its plant, appellee intended primarily to produce magnesium oxide, but that it sought to salvage a recovery from the gypsum precipitate, which would be a "valueless waste" (R. 133) unless further processing would make it saleable to appellant, whose cement plant was in close proximity (R. 788, 789). The parties clearly did not contemplate, and there is not one line of testimony in the record to suggest they contemplated, that the by-product gypsum should bear the general and administrative and other indirect costs that would in any event be incurred in the manufacture of the plant's principal product. Every writing that passed between the parties indicated not only that the original price was based upon direct costs, but that the only costs in contemplation of the parties were direct costs.

B. The circumstances under which the contract was made show that the contracting parties contemplated only direct cost.

In 1936, Stanley H. Barrows, the president of appellee's predecessor, approached J. H. Colton, vice president of appellant corporation, to seek a buyer for the output of by-product gypsum at the then planned Newark plant (R. 773). The favorable factor that this plant would be located near appellant's cement plant at Redwood City, gave marketability to the by-product gypsum, which would otherwise have been a "valueless waste" (R. 788, 789). The conversations between Barrows and Colton resulted in a letter from Barrows, dated June 5,

1936 (Plf. Ex. 5, R. 164), which outlined the terms of a contract and stated in paragraph 11 (R. 166):

“Contract would contain certain price protection clauses to guard against increases in labor, fuel and supplies * * *.”

Mr. Barrows was plainly concerned only with increases in only three items of direct out-of-pocket cost.

The proposal of June 5, 1936, was followed on September 18, 1936, by a more detailed draft of proposal submitted by Barrows (Def. Ex. H, R. 881-893). Paragraph 6 of this proposal (R. 888, 889) also shows that Mr. Barrows had in mind price protection only against increases in direct costs:

“* * * in the event of price advances and [sic] labor, transportation, fuel or supplies, resulting in an increase of 5 per cent or more in cost * * *.”

The proposal of September 18, 1936, reveals a further significant fact which the lower court did not perceive. The opinion states (R. 70):

“The record does not show what, if any, cost figures were utilized in fixing the basic contract price of \$2.80 per ton.”

The initial price of gypsum provided in this proposal was \$2.80 per ton (paragraph 4, R. 886). The same price became the initial price under the contract that was signed (R. 10). The price of \$2.80 per ton was based upon California Chemical Company's direct costs.¹² Paragraph

¹²The direct cost in the first year of production (1938), including direct shipping expense and taxes, insurance and depreciation on the gypsum portion of the plant was \$2.11 per ton (R. 565, 573). This allowed appellant a mark-up of 69 cents, or 33 per cent.

6 of the proposal states (R. 888, 889) that the prices "*are based upon the average direct cost to California to produce the materials covered by this agreement during the first year's operation of the contemplated new plant proposed to be erected at Canal Head, Newark, California * * *.*"

Concerning this, Mr. Barrows testified (R. 798):

"Q. It was upon that basis of your direct costs that this contract, proposed contract price of \$2.80 a ton was based; is that it?

A. Right. The direct costs at that time."

On the subject of his later discussions with Mr. Colton, Mr. Barrows testified (R. 764, 792, 794) that because his company's right of termination contained in his proposals was unacceptable to appellant, he did not want to be limited to labor, fuel and supplies—that other items were discussed (R. 766). He could not say what those other items were (R. 766). The most that Mr. Barrows could say with reference to what costs were to be included was, "My thought was to 'leave it to the accountants, what cost of production is' " (R. 872). Appellant does not contend that appellee is limited to labor, fuel and supplies; it agrees that all direct charges may be included. *But there is not one word of testimony in this record by Mr. Barrows or by anyone else that "indirect" or "overhead" costs were ever mentioned to or discussed with Mr. Colton or any other representative of appellant in the negotiation of this contract.* On the contrary, Mr. Colton testified that it was never suggested such costs could be used as a basis for price increases. The discussions were at all times limited to direct costs (R. 1095, 1096).

C. Appellee's practical construction of the contract after it was made shows it construed the contract as permitting price increases based only on increases in direct cost.

Not only did California Chemical Company (appellee's predecessor) consider in negotiating the contract that the "price protection" was to be against increases in direct costs; appellee's conduct more than four years after the contract was signed shows that it interpreted paragraph (6) to mean that price increases were properly based only on direct costs. In 1941, appellee notified appellant of the first price increase. It supported this increase by a statement of the costs which had increased, enclosing the statement with the following letter, dated October 2, 1941, to appellant's Mr. Canvin (Plf. Ex. 1, R. 99-101):

"In accordance with request of yourself and J. H. Colton, while in conference with Mr. Wallace yesterday, we have analyzed gypsum production costs for the years ending June, 1940, and June, 1941. We are attaching hereto a recapitulation of labor, material and power costs which accounts for 15 cents per ton of the 18 cents per ton increase of which you have been previously notified, and which increase is effective October 5, 1941.

If you desire further information in re the attached statement, or in connection with our basis of determining increase in cost, please call on the writer.

Yours very truly,
WESTVACO CHLORINE PRODUCTS CORP.,
O. H. HURLBURT,
Chief Accountant."

The statement attached to this letter made no reference whatsoever to any costs other than direct costs (R. 101). It was clear from the statement and the letter that appel-

lee considered "gypsum production costs" to be direct costs. The statement showed that 15 cents of the 18-cent per ton increase claimed was due to increases in only three of the direct costs, i.e., labor, materials and power. Assuming that the other three cents was due to other direct charges of a minor nature (R. 597), appellant paid the increased price without seeking further detail (Plf. Ex. 13, R. 232, 242). It was not until January of 1944 that appellee informed appellant it asserted the right to base price raises on "indirect costs," costs that would go on even if no gypsum were produced (R. 105, 596-600). Appellant promptly objected (Plf. Ex. 4, R. 151-153).

The court below attached unusual significance to this statement of the first price increase and drew from it an inference directly opposite to that stated above (R. 70-72). It expressed the view that appellant could not have "ignored" the fact that "one-sixth of such increase resulted from an increase in indirect costs" (R. 72), and treated the conduct of appellant in making no protest to this first price increase as a recognition that indirect costs could be charged to gypsum under the contract.

It is clear beyond controversy, we submit, that this conclusion is erroneous. It is not true, as the court said, that one-sixth of the increase "resulted from an increase in indirect costs" (R. 72). The statement contains no reference of any kind to indirect costs, and the unexplained 3 cents was obviously an amount that reasonably would be considered to cover only direct costs other than labor, materials and power. The court's error on this point is conclusively shown by appellee's corrected account of this first cost increase. Nearly three

years after the 1941 statement was sent to appellant, appellee supplied a new statement of the costs claimed to support the 1941 increase (Def. Ex. A, R. 351, 353, 355). This statement showed, contrary to the data given in 1941, that the total increase in appellee's direct costs at that time was only 9 cents, and for the first time revealed that the remaining 9 cents consisted of increased indirect charges (Def. Ex. A, R. 351, 355, subtotal). If the original statement had been in this form appellant of course would have been put on notice that indirect charges were being included. But the original notice, making no mention of indirect charges and erroneously magnifying the increase in direct charges, clearly did not put appellant on any such notice. On the contrary it gave appellant assurance that the 1941 increase was based only on direct charges.

D. Appellee's practices ignore and nullify the contract limitation that price increases may be based only on the "actual advance in [appellee's] cost of manufacture."

The very nature of "indirect" costs shows they were not within the contemplation of the parties when they provided that price increases should be "in an amount not to exceed the actual advance in [appellee's] cost of manufacture."

Appellee's experts agreed that the direct costs are susceptible of accurate ascertainment (Farquhar, R. 1127; Maxwell, R. 1148; and Alexander, R. 1187). Comparison of these charges, period by period, would definitely reveal any "actual advance" in the cost of manufacture. The indirect or overhead charges, on the other

hand, cannot be ascertained. It is for the very reason that these charges cannot be ascertained with respect to a given product that they are classed as "indirect" or "overhead" (Maxwell, R. 1150). Allocation of certain of these items on a labor basis has been made by appellee (Plf. Ex. 15, R. 276; Plf. Ex. 17, R. 557; Watt, R. 907). This, of course, produces only an estimate, and according to appellee's own accounting witness the labor basis is not "necessarily the sound measure of allocating overhead"; there are other methods more reliable (Farquhar, R. 1125, 1127).

Testifying with regard to the overhead items appellee has charged to by-product gypsum, as shown in appellant's Exhibit 18 (R. 563-573), appellee's expert Alexander stated that the allocation would be made "without any reason as to how or in what way the particular items specifically had to do with gypsum" (R. 1192).

A good example of how this operates was disclosed by appellee's office manager Watt. Although on the labor basis 7.8 per cent of all engineering costs were charged to gypsum, he admitted he knew nothing about the engineering services or whether any increase actually had occurred in engineering service devoted to gypsum (R. 1020, 1021). Nevertheless "Engineering" overhead charged to gypsum increased, according to appellee's figures, *eightfold* from 1941 to 1946 (Plf. Ex. 18, R. 563, 569). During the same period "Purchases and Stores" overhead increased *sixfold*, "Newark Shop and Maintenance" overhead increased *fifefold* (R. 569), and indirect shipping expense increased *fourfold* (R. 573). In contrast, direct charges, including direct shipping ex-

pense, taxes, insurance and depreciation, increased during the same period only a little over one-fourth—from \$1.31 to \$1.67 (R. 565, 573). Appellee has offered no explanation as to how these huge increases in bookkeeping charges are actually related to or were incurred by gypsum production.

These overhead and indirect charges to gypsum are not only based on hypothetical assumptions, at best resulting in estimates (Farquhar, R. 1128), but all of them would continue even if the by-product gypsum were not produced (Watt, R. 1036, 1037; appellee's answer to interrogatories 9(g) and 10(g), R. 1236, 1237, and 1238, 1239). Such increases as occur in these costs are attributable to the general conduct of appellee's operations and are not within the explicit requirement of paragraph (6) that the price increases must be in an amount not to exceed the "*actual advance*" in appellee's cost of "*manufacture*" of "*gypsum*."

It is a cardinal principle of interpretation that effect is to be given to every part of the contract (California Civil Code, sec. 1641). It would read the restrictive language of paragraph (6) out of the contract, to approve the practices appellee has followed, of increasing the price not only on account of actual increases in the ascertainable direct costs incurred in the manufacture of gypsum, but also on account of increases in the indirect costs of conducting its general business that, so far as gypsum is concerned, can be allocated only on the basis of hypothetical estimates.

Ever since this dispute arose appellee has insisted that it can charge to gypsum any and all costs that its uniform

national accounting system would assign (R. 112, 113). Mr. Williams, then assistant to the president of Westvaco, argued in 1944 that appellee could not change its uniform accounting methods for one particular purpose such as this contract (R. 173). It was pointed out to him at that time that appellee could easily keep a few auxiliary accounts for the contract, as appellant does when it has special contracts (R. 173). As Mr. Webster of Haskins & Sells testified, "It is not at all uncommon for a company involved in the sale of a particular product to make separate computations of its costs for the purpose of the contracts which may be entirely different from the cost shown on the books" (R. 515). Further, appellee has made changes in its general accounting methods for the purported purpose of accomplishing uniformity of accounting practices between appellee's various units (R. 938) and has insisted that these changes may reflect in an increase in the price of gypsum to appellant—even though certain of these changes have had the admitted effect of loading gypsum with costs previously borne by other products (Watt, R. 956, 957; 1006-1010).

It is not, we submit, the uniform national system of accounting employed by appellee nor such changes in its accounting methods as it may make for its own internal purposes, that govern price increases charged to appellant. It is the intent of the parties as found in the interpretation of *this contract*, and that intent, as is shown by the prior negotiations, appellee's subsequent conduct, and by the instrument itself, is to base price increases on increases in direct cost.

In point is *Lincoln Rug Co. v. East Newark Realty Corporation* (Ct. of Err. and App., N.J., 1948) 61 Atl. 2d 448. There the court had before it a lease which provided (p. 450):

“If Landlord’s *cost to produce* steam shall increase between the time of the signing of this lease and the beginning of the term provided for herein, Landlord shall, upon proof thereof, have the right to increase the charge to Tenant sufficiently to compensate Landlord therefor to the extent of Tenant’s Steam consumption.”

The court stated (p. 450): “The chief question of difficulty in the case goes to the expression ‘cost to produce steam.’ ” The court found the answer to that question, not in abstract accounting principle, and not in the landlord’s accounting practices, but in intent of the parties (p. 450):

“The meaning of the term ‘landlord’s cost to produce steam’ depends upon the construction of the contract, that is, the intention of the parties.”

The trial court in that case had selected a firm of accountants to examine the landlord’s accounts. The report of these accountants included in the “cost to produce steam” charges like those appellee has made in the case at bar. One of such charges was an allocation of the landlord’s cost of electricity, based on a “guess” or estimate as to the amount used in the power plant where the steam was produced. The court ruled (p. 451) that “the price of steam should not depend on this kind of estimate,” and that the contractual intent of the phrase “landlord’s cost to produce steam” required the exclu-

sion of the allocated indirect items the accountants had allowed. It was the landlord's direct charges which the court found to comprise the "landlord's cost to produce steam."

While the phrase "not to exceed the actual advance in [appellee's] cost of manufacture" in a similar contract apparently has not been judicially construed, a number of cases have decided the meaning of the word "actual" in relation to cost, and have established that the word "actual" is a restrictive one which contemplates only direct costs and excludes the indirect or general expenses of doing business.

In *State v. Tonopah Extension Mining Co.* (1926) 49 Nev. 428, 248 Pac. 835, the court had before it the term "actual costs of extraction, transportation, reduction or sale of ores." It held (p. 837):

"The common sense of the thing is that it means the money actually expended in the extraction, transportation, and reduction of ores. The word 'actual' is a word of limitation, as distinguished from all costs of conducting the business."

A kindred case was *Anaconda Copper Mining Co. v. Junod* (1924) 71 Mont. 132, 227 Pac. 1001. The phrase there construed was "actual cost" of extracting, reduction or sale of ore. Here also the court held the term was a restrictive one." * * * not all, but only the *direct* costs and expenses were contemplated * * *" (p. 1004).

In *Lexington and West Cambridge Railroad Company v. Fitchburg Railroad Company* (9 Gray), 75 Mass. 226, the case turned upon the meaning of the phrase "the actual cost" of running extra trains. One party to the

contract charged the other with a proportion of the entire annual cost and expense of its business. It was held that such charge was not proper (p. 230):

“The term ‘actual cost’ in the agreement declared on, means money actually paid out for extra trains. All the items of expense, which are objected to, would have been incurred whether the extra trains had been run or not, except the wear and tear of the defendant’s track * * *” [and that was covered in another part of the agreement].

It is just such expenses that we ask this court to exclude—the indirect costs that would have been incurred whether or not the by-product gypsum were produced.

In the case of *In re Directors of Old Colony R. Co.* (1904) 85 Mass. 160, 70 N.E. 62, the court held that the ‘actual cost’ of grade crossing alterations by a railroad did not include certain interest charges. Its language is apt in the case at bar (p. 63):

“* * * if such an item is to be included either under the term ‘expense’ or that of ‘actual cost’ then there is no logical limit to sweeping into such a classification everything that directly or collaterally calls for expenditure, or cost, or loss by a railroad company * * *. That such a construction would open the door to let in claims that would be not only large in amount, but uncertain and contingent in their character, is reasonably clear.”

We submit that the uncertain character of appellee Westvaco’s indirect charges has been fully demonstrated. Upon these authorities they should be rejected.

If indirect costs were not excluded, and if the phrase ‘not to exceed the actual advance in [appellee’s] cost

of manufacture'' were not given the meaning contended for above, it could have only one other possible meaning, and one that is more restrictive to appellee. The alternative meaning of the phrase ''not to exceed the actual advance in [appellee's] cost of manufacture'' is that the aggregate of the price increases since the first year cannot exceed the 45-cent net increase in all its asserted costs from 1938 to 1946 (*supra*, p. 16). That would make the present price \$3.25 per ton, which is 27 cents less than the price appellant has offered to pay.

III.

EVEN IF IT SHOULD BE HELD THAT ALL INDIRECT CHARGES ARE NOT TO BE EXCLUDED IN DETERMINING THE COST OF PRODUCTION OF GYPSUM, NEVERTHELESS INDIRECT CHARGES TOTALLY UNRELATED TO GYPSUM, AND INDIRECT CHARGES NOT RELATED TO PRODUCTION, MAY NOT BE INCLUDED.

- A. Appellee's charge for ''new products research'' is totally unrelated to gypsum and its production and, under the contract, may not be used as the basis of a price increase.**

What has been said demonstrates, we submit, that appellee's direct costs of producing by-product gypsum are the only costs which may be taken into consideration in computing price increases to be charged to appellant under this contract. But even if it should be held that all indirect charges are not to be excluded, certain of these charges that appellee has used as the basis for price increases are clearly indefensible.

An item of ''Research'' of 12 cents per ton was advanced by appellee as the basis of a portion of the

second price increase (Plf. Ex. 18, R. 563, 569). All but a nominal part of this was due to "new products research" (Def. Ex. A, R. 351, 354). This new products research even included a project seeking a way to eliminate gypsum (Wallace, R. 1093, 1094), the cost of which appellee's own interested expert, Alexander, testified definitely was "not a proper charge" (R. 1195). Clearly "new products research" has nothing to do with producing gypsum. As testified by Mr. Flick (R. 292):

"By no stretch of the imagination, in my opinion, is New Products Research properly chargeable as a cost of manufacture of the by-product. You do not have to research on new products in order to dry, grind, and ship the by-product. It is just unrelated. It is not chargeable under any type of good accounting practice."

This testimony was uncontradicted. Indeed, Mr. Williams, assistant to appellee's president (R. 156), admitted that appellant's objections to this charge are justified (R. 175), and appellee's expert Farquhar testified that overhead dissociated from the manufacture of a particular product should not be allocated to it (R. 1132).

The contract permits price increases only as warranted by an "actual advance" in "the cost of *production of gypsum*" (R. 11). Research upon new products, products other than gypsum, conducted for the sole benefit of appellee, is manifestly no part of the cost of production of gypsum.

- B. Appellee's charges for expenses of a general and administrative nature are not expenses of production or manufacture and under the contract may not be used as the basis of a price increase.**

Appellee's charges to "cost of *production*" of by-product gypsum include, in addition to expenses relating to its manufacturing processes, numerous items of cost which are not elements of manufacturing or production cost. There is the following group of items, expenses of appellee's west coast operations (Watt, R. 930) of a general and administrative nature unrelated to *production* expense at the Newark plant, which account for 5 cents per ton of the 1944 increase and 6 cents per ton of the 1946 increase (Plf. Ex. 18, R. 563, 569) :

West Coast General Expense

West Coast General Supervision

West Coast Telephone and Telegraph

West Coast, New York office (this is a portion of appellee's New York office expense, first allocated to its West Coast operations, then allocated to the Newark plant, and finally allocated among the products manufactured at Newark (R. 1051)).

West Coast Exploration

West Coast Subscriptions and Donations

West Coast Production Cost Control

West Coast Personnel Department

West Coast Group Insurance

To charge a portion of these expenses to gypsum under the contract with appellant, one must read the term "cost of *production*" as though the limiting word "production" were simply not there.

In addition to the unanimous testimony of the experts called by appellant,¹³ appellee's own experts gave testimony that must exclude such expenses as these. Farquhar, testifying to the allocation of overhead to a product, spoke of "*factory overhead*" and "*indirect charges of the plant*" (R. 1111); he testified that things that do not relate to the production of the product would not be allocated to production cost (R. 1131); and that overhead dissociated from the manufacture of a particular product should not be allocated to it (R. 1132).

Maxwell's testimony that overhead could be charged was also limited to "*overhead and expense of the plant*" and "*indirect charges of the plant*" (R. 1136).

Alexander's testimony as to accounting principle was likewise confined to "*plant overhead*," and "*indirect charges of the plant*" (R. 1175-1177).

The meaning of these terms in accounting nomenclature is pointed up by the testimony of Mr. Flick. His testimony was that "*cost of manufacture*" or "*cost of production*" excludes expenses of a general and administrative character (R. 262). He further testified, by way of example, that overhead charged to his company's Gerlach, Nevada, plant (where no by-product is involved) includes overhead expense incurred *at that plant*—it includes no portion of the overhead from any other plant or from appellant's head office in San Francisco (R. 314).

Mr. Kenneth Pryor, of Price, Waterhouse & Co., likewise testified that in situations where overhead may be properly chargeable to a product, "*cost of production*"

¹³See note 10, p. 20, *supra*.

includes only manufacturing overhead, not general and administrative overhead (R. 666, 691, 701).

There is no conflict in the expert testimony on this point, except to the extent that Mr. Alexander (whose firm is appellee's regular auditor and who assisted appellee in the preparation of its case (R. 1186)) looked over an exhibit showing all the overhead charges appellee has made to cost of production of gypsum, and stated the bare conclusion that they were proper (R. 1184). And Watt, appellee's office manager, testified (R. 935, 936) that Plaintiff's Exhibits 15 (R. 276) and 17 (R. 557) correctly show the cost of production of gypsum. (These exhibits were schedules attached to appellee's answers to interrogatories (R. 272, 275, 557)). We submit that these self-serving conclusions are contrary to the overwhelming weight of the evidence, which requires that in any event these general and administrative expenses, dissociated from manufacturing operations at the Newark plant, be excluded from appellee's "*cost of production*" of gypsum.

IV.

APPELLEE CANNOT EMPLOY INCONSISTENT ACCOUNTING METHODS, IN TWO COST PERIODS BEING COMPARED, IN DETERMINING THE COST OF PRODUCTION OF GYPSUM. FICTITIOUS INCREASES IN INDIRECT SHIPPING EXPENSE AND THE EXPENSE OF AN AIR COMPRESSOR, RESULTING SOLELY FROM THE USE OF INCONSISTENT ACCOUNTING METHODS AND NOT FROM AN ACTUAL ADVANCE IN COST, MUST BE EXCLUDED FROM THE PRICE INCREASE.

If appellant is correct that indirect charges may not properly be employed under the contract in suit in determining price increases, the claimed cost items dis-

cussed in the following portion of appellant's argument would be excluded in any event. Assuming *arguendo* that indirect costs can be so employed, the seeming "increases" next considered must nevertheless be excluded, because they arise not from any increase in expense incurred by appellant, but solely from the use of inconsistent accounting methods in two periods being compared.

The most striking example of a fictitious cost increase, caused solely by a change in appellee's accounting method, concerns the item of indirect shipping expense. Appellee's third price increase was based upon a comparison of the cost of production of gypsum for the twelve months from July 1, 1945, to June 30, 1946, with the cost for the preceding twelve months' period from July 1, 1944, to June 30, 1945 (Plf. Ex. 10, R. 220, 221). Prior to June, 1945, indirect shipping expense was allocated on a value basis (R. 735, 736)—that is, the total indirect shipping expense was divided between gypsum and magnesium oxide in the proportion that the sales value of each bore to the total sales value of both (R. 909). On this basis, gypsum bore approximately $8\frac{1}{2}$ per cent of this expense, since the sales value of gypsum is many times less than that of magnesium oxide (R. 952-955). In June, 1945, the basis of allocation was changed to divide the expense between the two in proportion to the tonnage of each product shipped (R. 909). Since the tonnages of the two products are nearly equal, gypsum was charged with approximately 40 per cent of indirect shipping expense in the twelve months from July 1, 1945 to June 30, 1946 (R. 956, 957), as against only $8\frac{1}{2}$ per cent in the preceding twelve months. The cost

of handling gypsum actually remained the same (R. 958-959). Thus if 8½ per cent had been charged in both periods, or if 40 per cent had been charged in both periods, there would have been no increase in the indirect shipping expense charged to gypsum in the second period. In fact, due to appellee's use of inconsistent accounting methods in this allocation, appellee's books were made to show a 2 cent per ton increase (Plf. Ex. 18, R. 563, 573)—and that amount, a purely fictitious bookkeeping entry, was added to the price increase claimed.

On the subject of this "refinement" in accounting method, appellee's office manager Watt testified (R. 957):

"Q. Now, the effect of that change or refinement in your accounting methods, as I understand you to describe it, had the effect of loading onto gypsum a charge that formerly had been borne by your other products, isn't that correct?"

A. That is correct.

Q. And so far as the price that Pacific Portland Cement Company would have to pay for the gypsum, assuming that that was a proper charge of the cost of manufacture, that change in method would increase the price Pacific would have to pay for its gypsum during the next period, wouldn't it?"

A. It would.

Q. So that change or refinement in your bookkeeping process had the effect of substantially shifting the charge from your other products to gypsum, isn't that right?"

A. That is correct."

Another such change was in the method of accounting for the cost of use of an air compressor. Prior to March,

1945, this item was included in "General Plant Expense," an overhead account (R. 1006). Beginning in March, 1945, a percentage was charged directly to gypsum (R. 1006, 1007). There was no change in the manner or degree of the actual use of the air compressor or in its cost (R. 1014); but the accounting change increased, by about four times, the portion of this item charged to gypsum (R. 1009), and increased the asserted price 1 cent per ton (R. 1010).

The effect of the two changes just discussed was artificially to raise appellee's "cost of production" of gypsum, and the price asserted, 3 cents per ton. Because of the long term of the contract, such minor differences cumulatively involve large sums. Gypsum production in the year ended June 30, 1946, was 36,658 tons (R. 565). At the rate of even 30,000 tons a year, the 3 cent difference involved in the indirect shipping and air compressor items would amount to about \$14,400 over the sixteen-year period in suit. In addition, the principle involved is of the utmost importance and affects other items, both present and future, involving very substantial sums.

All of the accountants called by appellee testified that accounting methods must be consistent from year to year, where costs of production for two periods are being compared (Flick, Webster, Draewell, and Pryor, R. 261, 262; 340; 559; 622; 635; 644 and 715). There was no contradictory testimony of any kind. Indeed, the point is self-evident.

Mr. Watt, appellee's office manager, sought to justify appellee's several changes in accounting method on the

ground that the changes were instructed by appellee's New York office (R. 938, 939) "to accomplish uniformity of accounting practices between the various units of defendant company" (R. 938). Obviously, this is no justification for using the changes as a basis for increasing the price charged appellant. In addition, Mr. Watt when pressed admitted that some of the changes he made on his own initiative, including the change as to shipping expense above commented upon (R. 939, 1012). He admitted there were no written instructions on the subject of these changes from the New York office (R. 940, 941). He admitted he could recall no specific instructions and finally that his statement as to the New York office instructions for some of the changes was pure conjecture (R. 941, 942).

Appellee has made other changes in accounting method, as disclosed in its answer to one of appellant's interrogatories (R. 735-736).

"Prior to January 1, 1944, all overhead expense was allocated on the basis of operating labor and repair labor expense. Commencing January 1, 1944, and until January 1, 1946, general overhead expense was allocated on a combined supervision and operating labor basis. Maintenance and engineering costs were allocated on a repair labor basis. Process control and control laboratory costs were allocated on a direct basis with the balance of the costs of these two departments pro-rated over the direct allocation. Commencing January 1, 1946, and during the period from that date to and including June 30, 1946, the same procedure was followed with the exception that general overhead was allocated on a combined operating and repair labor basis."

During the trial appellee had in preparation a tabulation showing what effect these changes had upon the cost of production of gypsum as shown by appellee's books (R. 913). On Wednesday, December 24th, Mr. Watt testified that he expected to have this tabulation on Friday, December 26th (R. 913). The trial closed on Friday, January 2, 1948 (R. 1174), the holidays having intervened, without his producing the tabulation. In the absence of this tabulation, appellant has no way of knowing the effect of these changes, and does not know to what extent these changes may have entered into the price increases appellee has claimed. If, as we confidently expect, this court declares that the use of inconsistent accounting methods in two periods being compared cannot reflect in price increases, no doubt the parties can ascertain and agree upon any effect these accounting changes have had without the necessity of taking further testimony.

V.

A CHANGE IN ACCOUNTING METHODS, AND NOT AN ACTUAL ADVANCE IN COST, IS THE ONLY BASIS FOR THE NEW CHARGE OF 23 CENTS PER TON FOR THE SULPHURIC ACID. THIS FICTITIOUS INCREASE MUST BE EXCLUDED FROM THE PRICE INCREASE.

The sulphuric acid charge is one of the largest single items in dispute. Its entire cost is now charged to gypsum (R. 286, 927). This is a wholly new charge. Never in the ten years this contract has been in effect was any charge whatsoever made to gypsum for sulphuric acid, until the period ending June 30, 1946 (R. 927; Plf. Ex. 18, R. 563, 565).

Appellee tried to explain the absence in all the prior years of any charge to gypsum for sulphuric acid on the basis that in those years it was all charged to bromine and now bromine is not produced (R. 926). It is an undisputed fact that when bromine was being produced, the sulphuric acid remained in the bittern after the bromine process (Melhase, R. 831), and that sulphuric acid has always served the same function in gypsum production, whether or not bromine is produced. Appellee's office manager, Watt, so testified (R. 1015). There has been no change in the process of production of gypsum, but merely a bookkeeping change. Mr. Watt testified that his change in the assignment of the charge for sulphuric acid had the effect of raising the price to appellant 23 cents a ton (R. 1015). Appellee clearly cannot raise its price to appellant 23 cents a ton because in one period it does not choose, and in a following period it does choose, to charge gypsum with a material that in operation has had an unchanged effect on gypsum and has at no time increased in cost.

Again, there is no conflict in the expert accounting testimony that good accounting practice requires the application of consistent accounting methods, and that the "increase" claimed because of the new sulphuric acid charge was merely the result of a change in accounting method and not based upon any increase in cost. This was the uncontradicted testimony of Mr. Flick (R. 285) and Mr. Pryor (R. 647). Appellee's accounting experts did not testify on the subject.

The fact that bromine production stopped does not justify this bookkeeping change. There was no change

in gypsum production or in the cost of sulphuric acid, but simply a loss of production of a different product in another portion of the plant. Appellee is free, if it wishes for its own purposes, to take this cost formerly borne by bromine and charge it to gypsum or any other product. It is not free, however, to claim a price increase under this contract because of that. Reassignment among appellee's products of an expense that has always been present is a change in accounting, and not an "actual advance" in that expense. Approving appellee's reassignment of this sulphuric acid expense as an "actual advance in [appellee's] cost of manufacture" would produce this result: When manufacture of bromine is resumed and the sulphuric acid again charged to it, the "cost of production" of gypsum on appellee's books will appear to go down. The price to appellant would remain, however, at the 23-cent higher level. A second discontinuance of bromine production would again shift the cost of sulphuric acid back to gypsum and a comparison of the two periods would again show a further increase in the cost of production in the total amount of the sulphuric acid cost. Because of this accounting treatment of sulphuric acid, appellant would then be paying an additional 46 cents per ton for gypsum, although no actual increase in cost ever had occurred. Alternate shutting down and resuming of bromine production in this manner could pyramid duplicating charges to a point where appellant would simply be forced to cancel the contract.¹⁴

¹⁴In view of the prospective application of this court's decision, we feel it proper to bring to the attention of the court the fact that the fourth price increase, which was claimed by appellee after judgment was entered below (see note 3, p. 4, *supra*), includes

Obviously, such charges are grossly improper and have no relation to any "actual advance in [appellee's] cost of manufacture." It is completely untenable that interruptions in manufacture of a separate product determine the cost of production of gypsum, and the "actual advance" in that cost.

VI.

APPELLEE'S METHOD OF CHARGING DEPRECIATION HAS PRODUCED AN UNREAL INCREASE THAT DOES NOT ACTUALLY EXIST AND MAY NOT BE USED AS THE BASIS OF A PRICE INCREASE.

Appellee uses the "straight-line" method of calculating depreciation (R. 900), which concededly is a common one. It is hypothetical or theoretical, however. As the Supreme Court has pointed out, it is a mere calculation "based on averages and assumed probabilities" (*McCardle v. Indianapolis Co.*, 272 U. S. 400, 416). This method does not reflect the actual wearing out of the machine, but is simply a convenient method of writing it off (R. 409). It estimates the useful life of the equipment, and then charges to expense equal annual portions of its value (R. 902), so that when it is worn out, there has been placed in the depreciation account an amount equivalent to its value.

20 cents per ton more for sulphuric acid, caused by precisely the accounting treatment of interruptions in bromine production that is described above. The result is that after this fourth increase appellant is charged 43 cents per ton for sulphuric acid, when in fact there has not been an actual advance of a single cent in the cost of sulphuric acid, nor any change in the use of this material in gypsum production.

Use of the "straight-line" calculation of depreciation for the purposes of the contract in suit, however, creates a distorted and unreal semblance of increase in gypsum cost, where no increase has in truth occurred. This distortion is revealed by the increase which appellee claimed in its 1943 cost of production over its 1942 cost of production. The dollar amount of depreciation charged to gypsum in 1942 was \$12,221.68 and for 1943 it was \$11,099.35—*an actual decrease of more than \$1000* (Plf. Ex. 18, R. 563, 565). Because gypsum production dropped 23 per cent in 1943 from the quantity produced in 1942, from 31,826 tons to 24,431 tons (R. 565), however, appellee's calculations produced a depreciation charge for each ton of gypsum that was 7 cents higher in 1943 than it was in 1942 (R. 409, 410). There was no "actual advance" of 7 cents per ton in depreciation cost—the equipment does not wear out faster because less tonnage goes through it.

Although the tonnage of gypsum produced annually again rose to more than 33,000 tons and more (R. 565), appellee would have appellant pay, and continue to pay until the expiration of the contract, this 7 cents per ton charge which arose not from an "actual advance" in depreciation expense, but from a drop in production. Thus appellee would receive payments for depreciation which would pay for the gypsum equipment in much less than its useful life. It would receive payments which would replace the gypsum equipment at an annual production rate of 24,431 tons, when in fact the annual production has risen again to more than 33,000 tons.

Mr. Flick testified that where tonnage fluctuates and the object at hand is comparing the cost *per ton* in two accounting periods, the straight-line method gives a distorted result (R. 409, 410). Mr. Webster and Mr. Pryor also so testified (R. 514, 515; 653). Mr. Flick (R. 409-410), Mr. Webster (R. 514-515) and Mr. Pryor (R. 653) all testified that in such a situation the "unit of production" method of charging depreciation should be used; instead of charging depreciation by the straight line method, defendant should estimate the amount of gypsum that could be produced over the total life of the machinery and divide the value of the machinery by that figure (R. 409, 410). This would give a depreciation charge for each ton of gypsum that would not be affected by annual fluctuations in tonnage. This method would permit a true comparison of the cost of production of gypsum in one year as compared with another year, and would replace the gypsum equipment without requiring appellant to pay at a rate much more than sufficient to replace it.

Appellee's accountant Alexander, testified that the "straight-line" method of depreciation is proper to be used (R. 1184), and that the gypsum production equipment has a useful life primarily based on the time element, since it is subject to very heavy corrosion (R. 1185). He conceded that his opinion was not directed to any special situation posed by the contract in suit (R. 1190).

Appellant does not dispute that the "straight-line" method of depreciation is widely used, or deny that for its own internal purposes it is proper for appellee to use any

method of depreciation accounting it chooses. Mr. Webster stated that the use of the unit-of-production method for the purpose of one contract does not necessarily imply that the company must use that method in its own accounting (R. 515). The evidence is uncontradicted, however, that "straight-line" depreciation is improper for the purpose of determining whether, within the meaning of the particular contract in suit, there has been an "actual advance in [appellee's] cost of manufacture" of gypsum.

VII.

SUMMARY OF ACCEPTED AND DISPUTED ITEMS.

For the convenience of the court, there are set forth below in tabular form the asserted cost increases upon which the two price increases in litigation were based. The source of the data shown is Plaintiff's Exhibit 18 (R. 563-573). The parenthetical insertions indicate in brief recapitulation why certain items are objectionable. (The first increase of October 5, 1941, amounting to 18 cents per ton and raising the initial contract price of \$2.80 per ton to \$2.98 is not sought to be adjusted in this litigation.)

Price Increase of March 15, 1944

(inoperative until September 4, 1946, because of

O. P. A. price control)

		Cost Periods Compared		Increase (or Decrease)
		Calendar 1942	Calendar 1943	
Items of Cost		Cost per ton		
Accepted	Labor, operations	\$.26	\$.39	\$.13
	Labor, repairs	.12	.16	.04
	Compensation insurance and Social Security tax	.02	.03	.01
	Materials, operations	None	.02	.02
	Materials, repairs	.06	.07	.01
	Water	None	.01	.01
	Power	.15	.18	.03
	Fuel	.10	.14	.04
	Insurance	.01	.02	.01
		<u>\$.72</u>	<u>\$1.02</u>	<u>\$.30</u>
Disputed	Interdepartment water (indirect—allocated)	None	.01	.01
	Depreciation (determined on wrong basis—straight-line instead of unit of production)	.38	.45	.07
	Overhead:			
	“West Coast” expenses (general and administrative —not production cost)	.10	.15	.05
	New products research (not related to gypsum)	None	.12	.12
	Other overhead	.32	.55	.23
		<u>\$.80</u>	<u>\$1.28</u>	<u>\$.48</u>

There were other items of cost charged in which there was no change. The total of all costs in 1942 was \$1.93 per ton, and in 1943 the total was \$2.71. The difference of 78 cents per ton was claimed as a price increase, to bring the prior price of \$2.98 per ton to \$3.76.

Price Increase of November 13, 1946

Items of Cost	Cost Periods Compared		Increase (or Decrease)
	July 1, 1944- June 30, 1945	July 1, 1945- June 30, 1946	
	Cost per ton		
Labor, operations	\$.32	\$.35	\$.03
Labor, repairs	.21	.25	.04
			Note 1
Materials, operations	.02	.05	.03
Materials, repairs	.11	.20	.09
Gas	.10	.12	.02
Direct shipping expense	.10	.15	.05
Insurance	.02	.01	(.01)
	<hr/>	<hr/>	<hr/>
	\$.88	\$1.13	\$.25

Note 1: Subtract \$.01 of the increase shown in Materials, Operations, caused by change in accounting method as to air compressor

\$.01

\$.24

Sulphuric acid	None	\$.23	\$.23
(caused by change in accounting method)			
Indirect shipping expense	\$.11	.13	.02
(caused by change in accounting method)			
Overhead:			
"West Coast" expenses	.13	.19	.06
(general and administrative —not production cost)			
Research, including new products research	.03	.07	.04
(not related to gypsum production)			
Other overhead	.58	.62	.04
Bittern	.18	.16	(.02)
(arbitrarily allocated)			
Depreciation	.38	.36	(.02)
(determined on wrong basis —straight-line instead of unit of production)			
	<hr/>	<hr/>	<hr/>
	\$1.41	\$1.76	\$.35

There were other items of cost charged in which there was no change. The total of all costs in the twelve months ending June 30, 1945, was \$2.52 per ton, and in the twelve

months ending June 30, 1946, the total was \$3.12. The difference of 60 cents per ton was claimed as a price increase, to bring the asserted price of \$3.76 per ton based on the raise of March 15, 1944, to \$4.36 per ton.

Upon appellant's arguments, the March 15, 1944, increase would properly be 30 cents¹⁵ per ton, bringing the prior price of \$2.98 per ton to \$3.28;¹⁶ and the November 13, 1946, increase would properly be 24 cents¹⁷ per ton, bringing the \$3.28 price to \$3.52 per ton.

VIII.

THE EVIDENCE REQUIRES THE ELIMINATION OF THE DISPUTED PRICE INCREASES CLAIMED BY APPELLEE. EVEN IF IT DID NOT, THE JUDGMENT SHOULD BE REVERSED, SINCE THE DECISION OF THE DISTRICT COURT WAS BASED UPON THE ERRONEOUS CONCLUSION THAT THE BURDEN OF PROOF WAS UPON APPELLANT INSTEAD OF APPELLEE.

The court below rested its decision that appellee had properly determined the cost of production of gypsum for the several periods involved, upon the ground that appellant had failed to prove that appellee's records were improperly kept and that the price raises were unjustified (Opinion, R. 73). This was error.

The law places the burden of proof of price increases upon the appellee, which has the affirmative of the issue

¹⁵Since appellant initially questioned the charge for insurance on the gypsum portion of the plant but does not here urge objection to it, these figures and the preceding tabulation are adjusted to reflect the 1943 increase and the 1946 decrease in insurance.

¹⁶See footnote 15, *supra*.

¹⁷See footnote 15, *supra*.

whether its costs have increased and to what extent. The burden is not shifted to appellant merely because it brought the dispute into court by suit for declaratory relief in lieu of waiting to be sued for the price claimed.

Appellant could have attempted self-help by refusing to pay the disputed part of the price and leaving it to appellee to sue for the enforcement of its claims. It is conceded (R. 995) that in such a suit appellee would have to prove the existence of the cost increases asserted by it. But by that procedure, breach of the contract would have been risked. Instead, appellant invoked the court's aid under the declaratory relief statute (28 U.S.C. §400, now 28 U.S.C. §2201) provided for just such cases.

In this proceeding appellee seeks to lift itself by its own bootstraps. It has the affirmative of the issue as to the existence and amount of any "actual advance in [appellee's] cost of manufacture" of the by-product gypsum. It is the one possessed of complete facts and records as to its costs. In the normal course it would have to prove the cost increases. Yet merely because the matter is presented to the court by way of a declaratory relief suit, appellee asserts that its burden is to be lifted and its claims given *prima facie* validity. That is not the law. In the language of the court in *American Ins. Co. v. Bradley Mining Co.*, 57 F. Supp. 545, 548, the declaratory relief statute is not "an instrument of procedural fencing."

The question as to the burden of proof in actions for declaratory relief most commonly arises in suits upon insurance policies. The insured has the burden of proving the insurance company's liability under the policy, and

usually the issue of liability is raised in an action brought by the insured. When the issue is presented in a suit by the insurance company for a declaratory judgment of non-liability, the burden of proof rests upon the insured, who has the affirmative of the issue, just as it would in an action by the insured. The leading case is *Travelers Ins. Co. v. Greenough* (1937), 88 N.H. 391, 190 Atl. 129, 109 A.L.R. 1096. The opinion is so cogent that we quote at some length (pp. 1098-1099):

“If the proceeding to determine the insurer’s liability were one brought against it, the general burden of proof would rest upon its adversary. It would be on the defensive, and a case against it would require a balance of proof to warrant a judgment against it. It is no less on the defensive here. Whatever the form of the proceeding, and notwithstanding its nominal position as a plaintiff, the real situation is that it is defending against a claim of its liability. The relief it seeks is primarily to have the claim adjudicated. Its position that the claim is without merit is necessary, in order to show that the claim is a controverted one. By instituting the litigation it compels the claimant to take action in assertion of his claim. He is required to establish it to entitle it to validity. The plaintiff does not prevail unless the claim is defeated, but the claim is defeated if it is not proved, and it is for the claimant to furnish the proof.

This view is thought to be just and fair. A contrary one would place the plaintiff in a position of undue disadvantage. Having the right to an adjudication of the claim without waiting for the claimant to institute legal proceedings, it ought not to suffer and to have to pay a price by exercising its right. No commendation of justice is perceived in making the plaintiff worse off by seeking a disposal of the con-

tentions between it and the claimant than by awaiting litigation commenced by the latter. * * *

Burden of proof is not imposed according to priority in taking legal steps to determine issues. And the Declaratory Judgment Act (Laws 1929, c. 86) discloses no purpose to shift the burden upon a party merely because he avails himself of the act. The statement of the act that a petition may be brought 'to determine the question as between the parties' does not change their relative normal positions in which one seeking redress must establish issues of fact in his favor by greater weight of evidence. Here redress is not sought except in the sense of relief from uncertainty. The right to have a disputed claim adjudicated does not predicate a duty to prove the claim unfounded."

This rule that the burden of proof remains upon the claimant or party having the affirmative of the issue, unaffected by that party's nominal position as defendant in a suit for declaratory relief, is followed in *Reliance Life Ins. Co. v. Burgess* (8 Cir. 1940) 112 F. 2d 234, *Thompson v. Baltimore & O. R. Co.*, 59 F. Supp. 21, *State Farm Mut. Automobile Ins. Co. v. Smith*, 48 F. Supp. 570, and *Liberty Mut. Ins. Co. v. Martel*, (1937), 88 N. H. 479, 192 Atl. 152.

This principle is also well established in the California law. *Roadside Rest, Inc. v. Lankershim Estate* (1946) 76 Cal.App.2d 525, 171 P.2d 529, was a case in which the plaintiff in the declaratory relief action alleged that the lease involved in the case had been modified; and it therefore had the burden of proving the existence of the modification. That the plaintiff had the burden of proof did not follow automatically from its position as plaintiff in the declaratory relief action—the court (p. 530) placed its

decision that the plaintiff had the burden of proof squarely upon "the fundamental proposition, reiterated in section 1981 of the Code of Civil Procedure, that 'The party holding the affirmative of the issue must produce the evidence to prove it * * *.'"

Only two federal district court decisions (in the Eighth Circuit) have stated the contrary position that the burden is always on the plaintiff, whether or not it has the affirmative of the issue.

Travelers Ins. Co. v. Drumheller (W.D. Mo. 1938)
25 F.Supp. 606;

Reliance Life Ins. Co. v. Faucher et al. (W.D. Mo. 1939) 30 F.Supp. 264.

The rule is otherwise in that circuit. Both of these district court decisions were discredited by the Eighth Circuit Court of Appeals in *Reliance Life Ins. Co. v. Burgess* (8 Cir. 1940) 112 F.2d 234. In that case the court held (p. 238):

"It is a fundamental rule that the burden of proof in its primary sense rests upon the party who, as determined by the pleadings, asserts the affirmative of an issue and it remains there until the termination of the action."

This rule, that the burden of proof is upon the party who, as determined by the pleadings, asserts the affirmative of the issue, has been followed in other recent federal court decisions.

Philip A. Hunt Co. v. Mallinckrodt Chemical Works
(E.D. N.Y. 1947) 72 F.Supp. 865, 873;

Lumbermen's Mut. Casualty Co. v. McIver (S.D. Cal. 1939) 27 F.Supp. 703, 704; affirmed (9 Cir. 1940) 110 F.2d 323.

In the case last cited the District Court for the Southern District of California held that the plaintiff insurance company which sought a declaratory judgment of non-liability had the burden of proof. This was correct because in that case the company in its pleadings set up what would have been an affirmative defense had the action been brought by the injured party. The court made it clear that the fact the suit was one for declaratory judgment did not shift the burden of proof (27 F.Supp. 704):

“It is apparent therefore that insurer’s contention that an unlicensed minor was operating the vehicle in violation of the state law and within the meaning of the exclusionary clause constitutes a special defense. Had this been a suit by the injured party directly against the insurer, such a contention would have been pleaded as a special defense. The fact that this is a suit for a declaration of non-liability, brought by the insurer as plaintiff does not alter the essential nature of the contention. It still amounts to a special defense.”

And further on:

“This conclusion is re-enforced by an examination of the pleadings. It is to be noted that the insurer’s allegation consists, not of a statement that Jeff Clark *was not* operating the automobile, but of an affirmative assertion that Gracie Vaughn was driving it. The burden of proving that fact rests on the one asserting it.”

In this case the pleadings leave no doubt that it is appellee who has the burden of proving affirmatively its right to increase the price of gypsum. As to the claimed increase of March 15, 1944, paragraph 7 of appellant’s complaint (R. 3, 4) first set forth appellee’s claim:

“On or about January 14, 1944, defendant notified plaintiff that, effective March 15, 1944, the price of gypsum would be increased under paragraph (6) of said contract to \$3.76 per ton, by reason of a further alleged increase of 78 cents per ton in defendant’s cost of production of gypsum.”

the complaint then denies the validity of this claim, alleging in the negative (R. 4):

“On information and belief plaintiff alleges that if defendant’s cost of production of gypsum had further increased at all it had so increased not more than 29 cents per ton.”

In answer to this negative allegation, paragraph 4 of appellee’s answer (R. 19) averred affirmatively:

“In this respect defendant avers that defendant’s cost of production of gypsum actually had increased 78 cents per ton and that pursuant to paragraph 6 of said alleged agreement, defendant was entitled to be paid \$3.76 per ton for gypsum delivered under said alleged agreement after March 15, 1944.”

As to the claimed increase of November 13, 1946, appellants negative allegations and appellee’s positive averments were also in this form (Complt. par. 8, R. 4; Answer, par. 5, R. 20). Clearly, it is appellee who asserts the affirmative of the issue whether its costs have increased in the amounts claimed. Appellee alleges that its costs have so increased and that it is entitled to be paid the full amount of such increase. In the words of the court in *Lumbermen’s Mut. Casualty Co. v. McIver*, supra, “the burden of proving that fact rests on the one asserting it.”

IX.

THE PLAIN LANGUAGE OF PARAGRAPH (5) OF THE CONTRACT REQUIRES THAT THE CONFORMITY OF EACH CARLOAD OF GYPSUM TO THE CONTRACT SPECIFICATIONS BE DETERMINED. TO MAKE THAT DETERMINATION A SAMPLE OF EACH CARLOAD MUST BE TAKEN—NOT A COMPOSITE SAMPLE OF THE CONTENTS OF SEVERAL CARLOADS.

Paragraph (5) of the contract (R. 10) provides that in the event “* * * any gypsum ($\text{CaSO}_4 \cdot 2 \text{H}_2\text{O}$) tendered to Pacific hereunder * * *” does not meet a specified standard, “* * * Pacific shall have the option as to any such gypsum ($\text{CaSO}_4 \cdot 2 \text{H}_2\text{O}$) either to (1) refuse to accept and pay for such gypsum ($\text{CaSO}_4 \cdot 2 \text{H}_2\text{O}$) or (2) accept such gypsum ($\text{CaSO}_4 \cdot 2 \text{H}_2\text{O}$) and pay therefor * * *” a reduced price.

Gypsum is tendered or delivered to appellant in rail carloads, each car containing about 50 or 55 tons (R. 212, 213). Appellant has at times resold a substantial part of it in carload lots moving directly from the Westvaco plant (R. 386). If a carload of gypsum is tendered to Pacific which does not meet the standard prescribed, it is clear on the face of paragraph (5) that the alternative remedies specified apply to that carload. There can be no doubt that under the express language of paragraph (5) appellant could refuse to accept and pay for the gypsum contained in that carload. The optional remedy of acceptance and payment at the reduced rate is obviously coextensive. In short, gypsum is tendered in carload units of shipment and appellant's alternative remedy applies to each carload unit tendered. There is no warrant whatever in the language of paragraph (5) for an interpretation that the option of rejection, or ac-

ceptance and reduced payment, applies only to the aggregate quantity of gypsum shipped in a week or in a 24-hour day, however many carloads might be shipped that week or that day.

For over nine years after entering into this contract appellee consistently construed the contract as above set forth. To apply the specifications clause of paragraph (5), laboratory analyses must be made of samples of the gypsum tendered. For nine years appellee took samples of each carload and furnished them to appellant's laboratory and its own (R. 212-213, 868). About a year prior to the trial, appellee for the first time refused to furnish carload samples (R. 213), asserting that the gypsum quality should be determined from a composite sample representing a week's production of gypsum or approximately twenty carloads. It has since furnished appellant only such composite samples (R. 213, 868-869). Appellee's western manager, Wallace, admitted to appellant that the change was made to eliminate appellant's price deductions for below-standard gypsum, as there would be averaging out of good and bad in a 20-car sample (R. 214). Clearly this is directly in violation of the contract, which gives appellant the right to reject or deduct for "any gypsum * * * tendered" that does not meet the specifications.

The court below decided upon a method of sampling unknown to the contract or to the prior practice of the parties, and one not contended for by either. It decided that a composite sample of all gypsum shipped in a 24-hour day should be used. It did so solely upon the ground that gypsum is fungible in nature and is shipped in bulk and

stored in quantities up to 500 tons (R. 57, 61, 65-66). While it is true that some gypsum is stored by appellant, it is also true that large quantities are shipped in carloads directly from appellee's plant to appellant's customers (R. 386). In any event, the facts recited by the court are entirely immaterial to the question presented. Those facts in no way justify ignoring the clear meaning of the language of paragraph (5) and ignoring appellee's nine-year recognition of that clear meaning. In deciding as it did the lower court was without any support in the contract or in the evidence.

CONCLUSION.

We respectfully submit that for each of the foregoing reasons and in each of the particulars above specified, the judgment of the court below is erroneous and should be reversed.

Dated, San Francisco, California,

March 21, 1949.

Respectfully submitted,

MARSHALL P. MADISON,

EUGENE D. BENNETT,

FRANCIS R. KIRKHAM,

WALLACE L. KAAPCKE,

Attorneys for Appellant.

PILLSBURY, MADISON & SUTRO,

Of Counsel.



No. 12,054

IN THE
United States Court of Appeals
For the Ninth Circuit

PACIFIC PORTLAND CEMENT COMPANY

(a corporation),

Appellant,

vs.

WESTVACO CHLORINE PRODUCTS CORPORATION

(a corporation),

Appellee.

BRIEF FOR APPELLEE.

CLAUDE N. ROSENBERG,

TADINI BACIGALUPI,

KENNETH RAY,

300 Montgomery Street, San Francisco 4, California,

Attorneys for Appellee.

BACIGALUPI, ELKUS & SALINGER,

300 Montgomery Street, San Francisco 4, California,

Of Counsel.

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IN THE

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PACIFIC PORTLAND CEMENT COMPANY
(a corporation),

Appellant,

vs.

WESTVACO CHLORINE PRODUCTS CORPORATION
(a corporation),

Appellee.

BRIEF FOR APPELLEE.

STATEMENT AS TO JURISDICTION.

Appellee concurs in the jurisdictional statement contained in appellant's brief.

STATEMENT OF THE CASE.

Appellant correctly observes that the principal dispute involved in this appeal concerns paragraph (6) of the contract.¹ Appellant contended in the trial court, as it does here, that the language means, and was intended to mean, that in determining the cost of production of gypsum only those expenses that are directly charged and precisely ascertainable should

¹Appellant's Brief, page 4.

be included, to the exclusion of overhead expense and other indirect charges which, because of their very nature, must be and ordinarily are allocated, on some rational basis, among the various products produced in a single plant.² Appellant sought to prove that gypsum, as produced by appellee, is a by-product and that in determining the cost to produce a by-product, it is improper accounting to include overhead expense and indirect charges. Appellee contended to the contrary—that “cost of production” as used in the contract was intended to mean all costs that are usually included in determining the cost of a manufactured product, including overhead expense and indirect charges; and that regardless of whether gypsum be considered as a by-product or a co-product, good accounting practice requires the inclusion of the latter items.

Substantially all of the evidence adduced at the trial related to these conflicting contentions and the concomitant question whether, as alleged by appellant,³ cost of production had been incorrectly determined by appellee from time to time, as the basis for the price increases established by appellee pursuant to paragraph (6) of the contract. Appellant also alleged that the payments made by it to appellee in the past exceeded the amount properly chargeable by appellee

²A typical example of allocated charges was given by appellant's vice-president in explaining how appellant, in its own plant, allocates the salary of the plant superintendent among the 4 products produced in the plant, using direct labor as the allocation factor, exactly as does appellee. (R. 315-316.)

³Par. 9 of Complaint, R. 5.

under the contract in the aggregate sum of \$9,405.93 for which sum appellant prayed judgment.

After a protracted trial during which the court heard 15 witnesses, including the two persons who negotiated the contract, and viewed 32 exhibits, the court found, on conflicting evidence, among other things, as follows:

1. That it was unnecessary to find whether or not the gypsum produced by appellee is a by-product, because "in determining the cost of production of a by-product which requires an independent physical plant, and independent labor to be performed upon it, in order to convert it into a marketable product, as does the gypsum produced by appellee at its Newark, California, plant, good accounting practice requires the inclusion of 'overhead expense' and 'indirect charges'." (Finding 2, R. 48.) Referring to appellant's contention that these charges should be excluded, the court stated in its opinion as follows:

"This position is not supported by the evidence, which shows that accepted accounting practice may charge to a by-product a proportionate share of indirect and overhead as well as the direct costs." (R. 72.)

2. That the cost of producing gypsum as determined by appellee from time to time, and the resultant increases in price so determined by appellee, have been in accordance with the terms and provisions of the contract. (Finding 8, R. 50-51.)

3. That the terms "cost of production" and "cost of manufacture" as used in paragraph (6) of the

contract, are synonymous, and that such terms "are not and were not intended by the contracting parties, or either of them, at the time of the execution of said contract, to be limited or restricted to 'actual' or 'direct' costs"; that such terms "include and were intended by the contracting parties to include overhead expense and indirect charges which cannot be directly charged to or against each of the various products produced by defendant at its Newark, California, plant, and which must, therefore, be allocated to or apportioned among such products on some reasonable basis; that in determining its cost of production of gypsum from time to time, defendant has fairly and reasonably allocated overhead expense and indirect charges thereto." (Finding 9, R. 51.) In connection with this finding, the court stated in its opinion that "it seems clear to the court that when the parties used the term 'cost of production' they intended to include all costs that might be shown by accepted accounting practice." (R. 72.)

4. That the specific costs, as determined by appellee for the three periods in question, and the three resulting price increases, were established by appellee in accordance with the terms and provisions of the contract. (Findings 10, 11 and 12, R. 51-55.)

5. That it is untrue that the payments for gypsum made by appellant to appellee during the period from September 4, 1946, to and including January 31, 1947, exceeded the amount properly chargeable by appellee under the contract by the sum of \$9,405.93, or any other sum or at all. (Findings 11 and 12, R. 53, 55.)

In paragraph 2 of the Specification of Errors, appellant asserts that the court erred "in failing to find" that for the purpose of establishing, under the contract, the actual advance in appellee's cost of manufacture and the resultant increase in price, it is improper to include overhead expense, indirect charges, new products research, expenses of a general and administrative nature, and depreciation on a "straight line" basis; and that the court likewise erred in "failing to find" that inconsistent accounting methods were improperly employed by appellee in two cost periods in determining the costs of sulphuric acid, indirect shipping expense, and air compressor.

By virtue of the findings above mentioned, the trial court determined that appellee had properly charged and included the items which appellant now disputes, and it approved the accounting methods that appellant questions. We conceive, therefore, that the errors specified by appellant in said paragraph 2, constitute an attack upon the sufficiency of the evidence to support these findings, notwithstanding that the alleged errors are phrased as a "failure to find" in accordance with appellant's contentions. We mention this for the reason that in its brief appellant argues, in effect, that the evidence preponderates in favor of appellant's contentions, or that the evidence introduced by appellant was more convincing than that presented by appellee. That approach would be proper in a brief addressed to the trial court. It serves no purpose in a brief on appeal, where all presumptions are in favor of the correctness of findings based upon

conflicting evidence. What appellant asks is that this court try the case *de novo* on the record, a practice which was condemned by this court in *Goldstein v. Polakof*, 135 F. (2d) 45. Furthermore, appellant has disregarded almost entirely a mass of substantial evidence which abundantly supports the findings, and to which we will refer in argument for the purpose of showing that the findings should be sustained.

ARGUMENT.

I.

INTRODUCTORY STATEMENT.

As stated by appellant, the correct determination of the issues involved upon this appeal are of vital importance to the litigants. The importance to appellee is greater than to appellant. Under the terms of the contract, appellant may restrict its purchases of gypsum to 20,000 tons in any year, if it so chooses, or it may cancel the agreement at any time on one year's notice, and thereby entirely relieve itself of further obligation thereunder. (Pars. 2 and 3, R. 9-10.) Appellee has no such right. Except for the 4,000 tons per year mentioned in paragraph (1) of the contract, it can be required to sell its entire gypsum production to appellant until January 31, 1962, at the price fixed under the contract. (Par. 2, R. 9.) Should the judgment in this case prevent appellee from including in its cost of production any item properly includable therein, the effect upon appellee during the

remaining term of the agreement would be extremely serious.⁴

At the outset of its argument, appellant takes occasion to direct the attention of the court to the fact that appellee's cost of production of gypsum, including both direct and indirect charges, increased only 45¢ per ton from the year 1938 to the period ending June 30, 1946, but that appellee is claiming an increase of \$1.56 per ton over the original contract price. (Appellant's Brief, p. 16.) It is pointed out that appellee's profit under the \$4.36 price is substantially greater percentage-wise than it was in 1938. From this it is argued that the men who negotiated the contract could not have intended "such results" in adopting the contractual language. This argument is totally without merit. The basic issue in this case was whether the term "cost of production" as used in paragraph (6) of the contract was intended to mean all costs, including overhead expense and indirect charges, or was restricted to direct costs. Whether the contracting parties anticipated or realized that the aggregate price increases under the contract at a particular time might exceed the aggregate increase in cost of production during the elapsed term of the contract is entirely irrelevant to this basic issue. The relation between appellee's profits in 1938 with those at the

⁴Appellant argued in the trial court that appellee had "something better than an escape clause" in that it could discontinue production of gypsum at any time. (R. 1276.) We submit that the privilege of discontinuing production of a product falls far short of the right to cancel a sales contract and thereafter sell the product at such price and to whoever the manufacturer desires.

present or at any other time is likewise of no significance.

Paragraph (6) of the contract is somewhat unique in that the escalator provisions thereof are not related to the cost of production in 1938 or in any other specific base period. This probably may be explained by the fact that the contract was entered into before the plant was constructed and hence before cost figures on production of gypsum were available. (R. 747.) Under the express language of paragraph (6) appellee is entitled to an increase in price if its cost of production in any 12-month period exceeds by 5% the cost in the preceding 12 months. Hence, the comparison of the increase in cost of production between 1938 and 1946 with the aggregate price increase under the contract during that period, is utterly meaningless. As dips and rises in production costs occur over the 25 year term of the contract, the price to which appellee is entitled in accordance with the provisions thereof may very well exceed the original contract price of \$2.80 by more than the amount by which the current cost of production exceeds the initial cost of production. That is a potentiality that is implicit in the fact that paragraph (6) provides for price increases premised upon the relation of cost in any successive 12-month periods, rather than on the cost at a particular time as related to the cost at some fixed base period. This is not the consequence of the accounting methods that are employed. The identical results could occur regardless of whether cost of pro-

duction were construed to mean only direct costs, as advocated by appellant, or to include also overhead expense and indirect charges, as contended by appellee and found by the trial court.

The use of the year 1938 for comparative purposes is particularly odious because that year would not constitute a fair criterion of initial cost in any event. Only 10,948 tons of gypsum were produced in 1938. Naturally, with small production unit cost was high, amounting to \$2.67 per ton. (Pltf's. Ex. 18, R. 565.) This left appellee a bare margin of 13¢ per ton, less deductions taken by appellant under paragraph (5) of the contract. In the 12-month period ending June 30, 1940, the plant first reached substantial production, the output being 27,685 tons, at a unit cost of \$1.66 per ton. (Pltf's. Ex. 18, R. 565.) If comparative figures were material, this is the first year that reasonably could be considered as representative of initial cost of production. Comparing this cost of \$1.66 per ton with the cost of \$3.12 per ton in the 1945-1946 period, shows an increase of \$1.46 per ton. This compares very closely to the difference of \$1.56 per ton between the price of \$4.36 and the original contract price of \$2.80. Appellee's profit was \$1.14 per ton under the \$2.80 price in 1940, and was \$1.24 per ton when the \$4.36 price became effective.

Although it is no more relevant than is the matter of appellant's profits, it is interesting to note that from 1940 to September 1946, appellant resold to Permanente at \$4.98 per ton the gypsum that it

purchased from appellee at \$2.80 and \$2.98, realizing a profit of \$2.18 per ton until October 1941 and \$2.00 per ton thereafter until September 1946. From the latter date until some time before trial, appellant received \$6.78 per ton or a profit of \$2.42 per ton over the price of \$4.36 which it paid to appellee. (R. 64, 385-386, 588.) Appellant now seeks an additional windfall of 84¢ per ton on all gypsum purchased under the contract since September 1946. (R. 385.) There is no evidence of the resale price obtained by appellant since cancellation of its contract with Permanente.

It is obviously not true that the inclusion of overhead expense and indirect charges in cost of production has brought about results that compel the conclusion that the contracting parties intended only direct costs to be included. The circumstances to which appellant referred have no bearing on that subject. What the effect of the escalator clause has been in the past or what it might be in the future is of no aid whatever in ascertaining the intention of the contracting parties as to the accounting procedure to be employed in determining "cost of production." The fact that indirect costs in the past have increased more than have direct costs is immaterial and purely coincidental. It is futile to relate price increases to cost of production in 1938, since that is not the basis specified in the contract. The intent of the contracting parties is not to be determined by hindsight. It is to be derived from

the language of the document and the circumstances attending its execution, as was done by the trial court. (R. 68.)

A similar point of equal speciousness is made by appellant, however timidly, at page 34 of its brief. Appellant there suggests the possibility that the use of the language "not to exceed the actual advance in cost of manufacture" indicates that the aggregate price increase since the first year cannot exceed the net increase in all asserted costs since that time. This interpretation was not asserted by appellant in the trial court. It is merely stated without argument in the brief and obviously is an afterthought that is not urged with any seriousness.

As just pointed out, price increases under the contract are not related to "cost of production" in the "first year" or in any other fixed base period. There is no language in the contract from which the suggested meaning could be derived. Appellant's own interpretation consistently has been and still is otherwise.

Over the elapsed term of the contract, appellee has claimed three price increases aggregating \$1.56, bringing the price to \$4.36 per ton. The first increase of 18¢ resulted from increased cost of production in the 12-month period ending June 30, 1941, above the cost in the preceding 12 months. (R. 3.) The second increase of 78¢ resulted from increased cost of production in the year 1943 over 1942. (R. 3-4.) The third increase of 60¢ resulted from increased cost of pro-

duction in the 12-month period ending June 30, 1946, above the cost in the preceding 12 months. (R. 4-5; Appellant's Brief, pp. 5-6.) Appellant disputes the overhead expense and indirect charges included in these cost figures but admits that appellee is entitled to an additional 72¢ per ton over the original contract price of \$2.80, or a price of \$3.52, by reason of increases in direct costs during the three comparative periods above mentioned. (Appellant's Brief, p. 6.) Yet, in each of the six years involved in these three periods, the direct costs were less than they were in 1938. (R. 565.) Thus appellant has itself effectively refuted its own passing suggestion that the language of the contract might mean that the aggregate price increases since 1938 "cannot exceed the net increase in all asserted costs" since that time.

II.

THE FINDINGS OF THE TRIAL COURT ARE PRESUMED TO BE CORRECT AND ARE TO BE ACCEPTED ON APPEAL UNLESS SHOWN BY APPELLANT TO BE CLEARLY WRONG.

Speaking of the interpretation of Rule 52(a) of the Rules of Civil Procedure by the Supreme Court in *United States v. U. S. Gypsum Co.*, 333 U.S. 364, this court very recently stated in *Grace Bros. Inc. v. Commissioner of Internal Revenue*, (No. 11976) '49-5 CCH Federal Tax Service, par. 9181, as follows:

"This interpretation is not a new departure. It merely stresses, as courts of appeal (including this court), have done before, that findings are

to be given the effect which they formerly had in equity.”

The rule in equity long has been that where a trial court, as in this case, has made a finding upon conflicting evidence, the finding is presumptively correct, and unless some obvious error of law has intervened or some serious mistake of fact has been made, the finding must be permitted to stand. (*Lincoln Nat. Life Ins. Co. v. Mathisen*, (9 Cir. 1945), 150 Fed. (2d) 292; *Warren v. Keep*, 155 U.S. 265.)

In this circuit the principle was stated in *Columbia Nat. Life Ins. Co. v. Quandt & Sons*, 154 Fed. (2d) 1006, as follows:

“Where there is a conflict in the evidence, this court must keep in mind that the trial judge who hears and sees the witnesses has a better opportunity to appraise their credibility and judge the weight to be attached to their testimony. * * * It is the rule that the findings of the trial court are to be accepted on appeal unless clearly wrong.”

Application of this principle requires that the findings in the instant case be sustained.

III.

THE TRIAL COURT PROPERLY FOUND THAT THE TERMS "COST OF PRODUCTION" AND "COST OF MANUFACTURE" AS USED IN PARAGRAPH (6) OF THE CONTRACT ARE NOT AND WERE NOT INTENDED BY THE CONTRACTING PARTIES TO BE LIMITED OR RESTRICTED TO "DIRECT" COSTS, AND THAT SUCH TERMS INCLUDE AND WERE INTENDED TO INCLUDE OVERHEAD EXPENSE AND INDIRECT CHARGES.⁵

- A. The evidence of the circumstances attending the execution of the contract supports the finding.

The first unit of appellee's plant at Newark, California, was constructed in 1930, being a plant from which bromine was extracted from bittern, as the sole product of the plant. (R. 743.) In 1935 a small "pilot plant" was constructed to experiment in the production of magnesium and gypsum from bittern. (R. 744-745.) Experiments continued for two years during which time numerous tests were made to determine the solubility of gypsum, and samples were submitted to appellant. (R. 746.) It was not until appellant approved the product that negotiations for the contract began. (R. 747.)

These negotiations were carried on between Mr. Colton on behalf of appellant and Mr. Barrows on behalf of California Chemical Company, the predecessor of appellee. The negotiations commenced some time around the middle of 1936. (R. 756, 1097.) This was approximately seven or eight months before the contract was executed on January 29, 1937. (R. 8.) After some preliminary conversations, under date of June 5, 1936, Mr. Barrows, at the request of Mr. Colton, wrote a letter "roughly outlining the terms

⁵R. 51.

under which he would contract for the sale of the gypsum.” (Pltf’s Ex. 5, R. 164-167, 758, 760.) This letter contemplated a contract under which California Chemical Company would purchase oyster shell from appellant and appellant would purchase lime and gypsum from California Chemical Company, the latter items to be produced in a plant which California Chemical Company expected to construct at Newark, California.⁶ In paragraph 11 of the letter it was stated that the contract would contain certain price protection clauses “to guard against increases in labor, fuel and supplies, some moderate minimum payment to keep the contract alive in depression or competitive siege, privilege of cancellation by us (California) on 15 months’ written notice, together with many other features not intended for preliminary contemplation.”⁷ Mr. Barrows testified that what he had in mind at that time was that if the cost of production got out of hand, California Chemical Company could cancel the contract. (R. 797.)

Under date of September 18, 1936, Mr. Barrows transmitted to Mr. Colton a draft of proposed agreement which again contemplated the sale of oyster shell by appellant to California Chemical, and the sale of lime and gypsum by California Chemical to appellant. (R. 761; Deft’s Ex. H, R. 881-893.) This draft of agreement, as did the letter of June 5, 1936, likewise reserved a cancellation privilege to California Chemi-

⁶The contract as finally executed provided for only the sale of gypsum by appellee to appellant—it does not involve the sale of lime or oyster shell.

⁷Throughout this brief all emphasis is added unless otherwise indicated.

cal Company, exercisable upon one year's notice. (Par. 12, R. 891-892.) Paragraph (6) of the proposed agreement provided for increases in the prices of lime and gypsum in the event of an increase of 5% or more in cost "above the first year's average direct cost."⁸ (R. 888-889.) Mr. Barrows testified that following the letter of September 18, 1936, he had further conversations with Mr. Colton in the course of which the latter objected to the cancellation clause. (R. 762.) Although Mr. Barrows had originally suggested an escalator clause based only upon increases in direct costs, at which time he had in mind that if costs got out of hand California Chemical could cancel the contract, the fact that Mr. Colton would not grant the cancellation privilege precipitated further discussion of costs for the better protection of the seller. (R. 792.) The bone of contention between Mr. Barrows and Mr. Colton was how to arrive at "cost of production." (R. 876.) Finally in December 1936, in conversation with Mr. Colton, Mr. Barrows insisted that he would not be restricted merely to the items previously mentioned as "there are other items that go to make up cost of production." Mr. Barrows mentioned a number of items, but Mr. Colton thought that they could not all be put into the contract. Accordingly, Mr. Barrows suggested and Mr. Colton agreed, that the contract merely specify "cost of production" and they would let the accountants decide what such cost was. (R. 766-767.)

⁸In the contract as executed, price increases were related to increases in cost in any 12-month period over the preceding 12 months, rather than being related to cost of production in the first year of operation.

It cannot be disputed that it would have been much more advantageous to appellant if the contract had expressly restricted price increases to increases in direct cost of production, as outlined in the draft of agreement transmitted on September 18, 1936, rather than to relate such increases to "cost of production" generally, as appears in the contract. The fact that the contractual language was changed from "direct cost" to the broad term "cost of production" is conclusive proof that the latter term was intended to embrace more than "direct cost". There is no other plausible explanation of the change. Keeping in mind that under the contract, as executed, appellant has the sole right of cancellation, whereas, Mr. Barrows originally intended exactly the reverse, the inference is irresistible that the change in language occurred under the circumstances and for the reasons testified by Mr. Barrows. Mr. Colton admitted that it was not he who suggested the change in the language, and that he would have preferred to have it stay as it was. (R. 1104.) Clearly, if Mr. Colton did not suggest it, Mr. Barrows must have—and for the reason, as he testified, that inasmuch as Mr. Colton not only refused to give California Chemical a cancellation privilege, but insisted that appellant alone have that right, Mr. Barrows was unwilling to confine price increases only to increases in labor, transportation, fuel or supplies, and insisted that they be related to all costs, determined in accordance with good accounting practice.

It was on the basis of this testimony that the court stated that it was "clear" that the parties

intended cost of production to include "all costs that might be shown by accepted accounting practice." (R. 72.) We submit that this is the only reasonable conclusion that could be drawn from the testimony. We submit further that no reasonable inference to the contrary could be drawn from the fact that from four to seven months prior to the execution of the contract, and in connection with a radically different agreement, both as to subject matter and language, Mr. Barrows was willing to confine cost of production to the specific items mentioned in his correspondence at that time.

In discussion of this subject, appellant criticizes the trial court for stating that the record does not show what, if any, cost figures were utilized in fixing the base contract price of \$2.80 per ton and argues that the evidence shows that the price was "based upon the average direct cost to California Chemical to produce the materials covered by this agreement during the first years' operation of the contemplated new plant proposed to be erected at Canal Head, Newark, California. * * *" (Appellant's Brief, p. 24.) This quotation is taken from the preliminary draft of agreement transmitted by Mr. Barrows on September 18, 1936, over four months before the contract in final form was entered into. The evidence is uncontradicted, and the contract so states, that construction of the plant was not even commenced until after the contract was executed. (R. 8, 747.) Obviously, the contract price could not, in fact, have been based upon production costs that had not yet been experienced.

Assuming that the price was based upon an estimate of certain costs during the first year of operation, the evidence is conclusive that, because of the radical change in the cancellation privilege insisted upon by Mr. Colton, Mr. Barrows was unwilling to premise future price increases on any restricted items or type of expense.

Appellant states that because gypsum is referred to in the contract as a "by-product", it must be inferred that the parties intended that in determining its cost of production, accounting procedure be followed which, according to appellant's experts, treats by-products different from other products. (Appellant's Brief, p. 21.) Appellant also argues that because there is no testimony in the record that "indirect" or "overhead" costs were ever expressly mentioned in conversations between Mr. Colton and Mr. Barrows, they could not have intended those charges to be included. (Appellant's Brief, p. 24.) Neither point is meritorious. These were two businessmen negotiating a contract. They were not accountants. (R. 797.) It is inconceivable that they had in mind the ethereal distinctions in cost accounting that appellant's experts advocated, as hereinafter discussed, or that in using the term "by-product" in the contract they intended the implications which appellant now attributes to the term. Admittedly there is no evidence that they ever discussed these fine accounting distinctions. However, that proves nothing. The evidence does show that Mr. Barrows suggested that the contract refer to "cost of production" and that they would let the

accountants decide what that is. (R. 766.) Mr. Colton ultimately agreed that this general language be used. (R. 767.) The trial court, with full opportunity to judge the credibility of the witnesses, accepted the testimony of Mr. Barrows and found accordingly. It found further, upon substantial evidence, that good accounting practice requires that overhead and indirect charges be included in cost of production of gypsum, even if it be considered a "by-product".

B. The expert testimony supports the finding.

Appellee's manufacturing processes at its Newark, California, plant are described in a general way at pages 4 and 5 of appellant's brief. The graphic depiction of these processes as shown in plaintiff's Exhibit 16 is sufficiently accurate for our purposes, although it does not show the bromine plant and the course of materials incident to that process. (R. 464, 1244.)

Three main groups of products are produced in appellee's plant—bromine, gypsum and a series of grades of magnesia.⁹ As to each of these products, all labor and other expenses related directly and exclusively to its production are charged directly to that product; other expenses, such as general supervision, which contribute to the production of the three products but which, because of their nature, cannot be segregated and charged on a direct time or cost basis to the respective products, are allocated between them.

⁹At the time of trial and for some time prior thereto, the production of bromine had been discontinued. (R. 926.)

(R. 904-911.) Direct labor cost, with certain minor exceptions, is used as the allocation factor. Thus, indirect charges are allocated to gypsum in the proportion that the cost of labor directly and exclusively employed in the production of gypsum bears to the sum of the direct labor charges employed respectively in the production of all products. (R. 735-736, 904-911.)

The trial court found not only that the inclusion of overhead expense and indirect charges was proper, but also that appellee's method of allocation has been fair and reasonable. (Finding 9, R. 51.) The expert testimony fully supports these conclusions.

A large part of the record in this case consists of the testimony of accountants. Appellant produced five such witnesses, including Mr. Flick, its vice-president.¹⁰ Appellee produced four.¹¹ Each witness who testified on the subject, including those produced by appellant, stated that in determining the cost of a manufactured product, it is proper and usual accounting practice to include manufacturing overhead and indirect charges.¹² Appellant's own witnesses conceded that the fact that such charges must be allocated between the various joint products produced in a single plant, and therefore are not precisely determinable in amount, does not detract from the propriety of

¹⁰Draewell, Flick, Jackson, Pryor and Webster.

¹¹Alexander, Farquhar, Maxwell and Watt.

¹²Webster (R. 531-532), Pryor (666, 716-717), Jackson (1210), Maxwell (1135-1137), Farquhar (1111-1112), Alexander (1175-1176), and Flick (314, 447).

including them in cost of production.¹³ Mr. Pryor stated that this is "common practice." (R. 685.) Mr. Webster referred to it as an "accepted method." (R. 532.) Professor Jackson called it "good accounting practice." (R. 1210.)¹⁴

Naturally, if several products are being produced in a plant and the production of one of them is discontinued, the overhead expense will nevertheless continue although perhaps in some lesser amount. Still, it is proper accounting to allocate a portion of the overhead to such product while it is being produced. (R. 446-448, 1112-1113, 1137-1138, 1176-1177, 1211.) After discontinuance of production, the overhead thereafter necessarily must be borne by and allocated among the products that continue to be manufactured. (R. 402, 1113.)

Appellant's witnesses, although affirming these general accounting principles and practices, asserted that they apply only to main products or co-products,

¹³Flick (R. 315), Webster (532), Pryor (718), and Jackson (1210).

¹⁴This testimony effectively refutes the argument at page 28 of appellant's brief that overhead is objectionable because the individual items comprising the aggregate account cannot be exactly supported either as to amount or direct relation to production of gypsum. If the items were directly and precisely supportable in these respects they would not be in the overhead account, but would be direct charges. As testified by Mr. Alexander, it is improper to impugn any single item contributing to aggregate overhead merely because it is impossible to prove or disprove precise accuracy of the charge. (R. 1192-1193.) It should be noted also that the overhead figures were prepared by appellee at the request, for the convenience of, and in the form requested by appellant—the individual items are not so allocated on the books. (R. 377-381; see legend, R. 569.)

and not to by-products. It was their opinion that only those expenses that are directly charged and exactly ascertainable in amount should be included in the cost of producing a by-product. (R. 501-502, 635, 668, 718.) They advocated the empirical rule that in the case of a by-product any expense which, because of its nature, has to be allocated is excludable for that reason alone, although it would be entirely proper to include it in the cost of a main product or a co-product. (R. 685, 718.)

The fallacy of this approach may be best illustrated by the testimony of appellant's experts on the subject of indirect shipping expense. The evidence shows that gypsum and magnesia are handled in a single shipping department. (R. 905, 955-956.) There are certain supervisory employees working in this department, such as foremen, who devote their time to the "handling of both products", but who, for practical reasons, cannot record the specific time devoted to each. (R. 904-905.) Accordingly, the expense of these employees necessarily is allocated between the two products in the same manner and for the same reasons that other overhead expense must be allocated. (R. 908.) Approximately as much gypsum is handled in the shipping department as magnesia. (R. 910.) Yet, appellant's experts stated that none of this indirect shipping expense should be charged to gypsum and that it all should be borne by magnesia; consistent with their general approach to the subject of allocated charges, they insisted that this expense must be excluded solely for the reason that it is not precisely

or accurately determinable in amount and therefore must be allocated. (R. 302, 445-448, 521, 694.) The complete lack of any rational basis for this theory was so apparent that even appellant's witness, Mr. Webster, found it impossible to go to that extreme. He finally conceded that under these circumstances it would be proper to charge this indirect expense to gypsum, even though it would have to be on some basis of allocation. (R. 539-540.) In fact, on the general subject of allocated charges he stated only that they are "objectionable but not necessarily totally excludable," depending on circumstances. (R. 536.)

Appellant's experts approached the problem from the viewpoint of a manufacturer who is determining whether it is economically advisable to process a by-product material or to throw it away or "let it wash down the sewer." (R. 503-504, 532, 535, 1203, 1207.) They conceded that their testimony was purely hypothetical and abstract in that they had no familiarity with the plant or processes in question. (R. 522-523, 623-624, 666-667, 1211.) Mr. Webster admitted that if he were called upon by appellee to set up its cost accounting, he would be unable to determine the proper methods and accounting principles to be employed without inspecting the plant and making a thorough study of the operations. (R. 523.) He stated that even as to a by-product, there is no single accounting method to be employed, but that all circumstances must be considered and the accounting methods adapted to the circumstances. (R. 529.) He admitted that in a chemical operation such as ap-

pellee's, where you start with a common raw material and you recover therefrom bromine in one department, gypsum in another, and magnesia in another, the three products might very properly be considered co-products for accounting purposes. (R. 530.) Professor Jackson likewise granted that where a product gets out of the category of waste or scrap, there are authorities who consider it proper, for accounting purposes, to treat it the same as a co-product, although he expressed the opinion that the best authorities are to the contrary. (R. 1220.)

Neither Professor Jackson nor any other expert produced by appellant could cite any text, paper or other authority for the abstract opinions that they expressed on the witness stand, or for their tenuous distinction between "co-product" and "by-product" cost accounting. (R. 470, 553-555, 629, 668-670, 1215-1216.) The record just referred to shows that each of appellant's experts, starting with Mr. Flick, was invited, on cross-examination, to refer to any authority that he might have that would support the theories which he advocated on the witness stand. The successive witnesses had every reason to anticipate that these questions would be put to them. Their inability to substantiate their expert opinions by any outside authority took on added significance under these circumstances and was commented upon by the trial court. (R. 672.) It was admitted that although appellant's experts collaborated in preparation for trial, in the course of those discussions, as well, no reference whatever was made to any authority that would sup-

port the theories which these witnesses advocated. (R. 670.)

Appellee's experts were unanimous in stating that, even assuming gypsum to be a by-product, good accounting practice nevertheless requires that manufacturing overhead and indirect charges be included in determining its cost of production.¹⁵ They took the practical and logical view that merely because overhead expense and indirect charges are not precisely ascertainable in amount, and, in the event of the discontinuance of one of a number of products produced in a plant, such charges would nevertheless continue, although in some lesser amount, there is just as much reason to include those charges in the cost of producing a manufactured product that is designated a "by-product" as there is in the case of a main product, a co-product, or a joint product.¹⁶

Appellant states at page 20 of its brief that these witnesses recognized that the exclusion of indirect charges from cost of production of a by-product is "an accepted and widely practiced method of accounting—indeed, the method most commonly found in practice." They did not so state, as a reading of the

¹⁵Maxwell (R. 1135-1138), Farquhar (1010-1013), and Alexander (1175-1183).

¹⁶Inasmuch as the Court accepted the testimony of these witnesses that it is immaterial for accounting purposes whether gypsum is or is not a by-product, we feel that it is unnecessary to refer to the testimony which, in our opinion, shows that it is not a by-product in accounting nomenclature. Suffice it to say that appellant's contention at p. 21 of its brief, that the reference to "by-product" in the contract is conclusive, is without merit. (*Moffatt v. Bulson*, 96 Cal. 106, 30 Pac. 1022; *Taylor v. Lundblade*, 43 Cal. App. (2d) 638, 111 Pac. (2d) 344.)

testimony referred to by appellant will reveal. The fact is, and it appears from the testimony of appellant's experts, that the most common accounting procedure in the case of a by-product is to keep no cost records at all, but merely to credit the proceeds of sale against the cost of the main product. (R. 530, 624, 1220-1221.) Obviously this is purely an accounting expediency for the convenience of the manufacturer and does not determine cost of production. It is equally true that any method of cost accounting which takes cognizance only of direct costs, to the exclusion of superintendence and other overhead or indirect charges, does not result in a true determination of cost of production, notwithstanding that it may be sufficient for the purposes of the manufacturer.

As stated by Mr. Farquhar, "You cannot obtain true costs of any production without some portion of the overhead." (R. 1111.) He said that in order to "get sound costs, you must absorb that overhead in the various products" (R. 1112), and the fact that you attach the label "by-product" to the product is immaterial. (R. 1115.) He approved direct labor as a "sound basis" for allocating overhead. (R. 1127.)¹⁷ This is the method of allocation employed by appellant itself in its Gerlach plant. (R. 314-316.)

¹⁷Appellant states that Mr. Farquhar testified that there are "other methods more reliable." (Appellant's Brief p. 28.) This is inaccurate. What the witness stated was that if allocation were made on the basis of the number of laborers, as distinguished from labor costs, there are other ways he would consider more reliable. In the instant case, the allocation is made on the basis of labor costs, rather than the number of laborers.

Mr. Maxwell explained that overhead must be allocated for the very reason that it is not a direct charge, but that this does not detract from the propriety of including it. (R. 1137.) The fact that overhead would continue, although in some lesser or unascertainable amount, even though one of several products were discontinued, regardless of whether that product is deemed a "co-product" or a "by-product", does not alter the fact that "while the product is being produced it should take its pro rata share of overhead." (R. 1137-1138.)

Mr. Alexander stated that "all the proper and accepted methods of accounting are equally applicable in the case of a joint product or a by-product"; that other methods sometimes are employed because of expediency in the particular case, but they do not result in determination of "cost of production." (R. 1178-1179.) This witness was able to testify subjectively, based upon his own inspection of the plant and familiarity with the processes therein. (R. 1179-1183.)¹⁸

¹⁸Appellant attempts to detract from Mr. Alexander's testimony on the ground that his firm is appellee's regular auditor and he collaborated with appellee in the preparation for trial. (Appellant's Brief, p. 20, footnote 10.) Mr. Alexander's familiarity with appellee's processes and accounting practices adds to rather than detracts from his qualifications. The fact that his firm is appellee's regular auditor does not discredit him any more than the mere fact that Mr. Pryor is a member of Price Waterhouse & Co., which firm is appellant's regular auditor, impeaches his testimony. (R. 173, 633.) The fact that Mr. Flick is an officer of appellant has not deterred appellant from resting heavily on his testimony. We confess to collaboration with Mr. Alexander just as appellant's experts undoubtedly collaborated with its counsel as well as with each other. (R. 670.)

Appellant would have it appear that its experts were better qualified than those produced by appellee. (Appellant's Brief, p. 20, Footnote 10.) We submit that the contrary is true. Of the four independent experts presented by appellant, neither Mr. Draewell nor Mr. Pryor testified to any experience whatever in cost accounting. (R. 621-622, 633-634.) The experts who testified for appellee demonstrated that they were eminently qualified on the subject. Mr. Farquhar has had vast experience in industrial accounting and is west coast representative of a well-known national firm whose practice is predominantly in that field. (R. 1109-1110.) He prepared a manual of cost accounting for the United States Navy Department. (R. 1116-1117.) Mr. Maxwell has practiced since 1921 "with the emphasis on industrial accounting, cost systems, their installations, the determination of costs for various purposes". (R. 1134.) He has had experience in the chemical, automobile, airplane, textile and other industries. (R. 1141.) Several years ago he wrote a treatise "Cost Control for Wineries" in which he asserted, as he did in court, that cost of production of a by-product should include overhead. (R. 1145-1146.) Mr. Alexander has also had experience in cost accounting, and as resident partner of a national firm, keeps himself informed on up-to-date professional knowledge. (R. 1174-1175.) Mr. Watt has had extensive accounting experience since 1919 and since 1933 has devoted himself exclusively to accounting in the chemical industry. (R. 879-880.)

We submit that in light of their qualifications and the logical tenor of their testimony, the trial court was fully justified in attributing the greater weight to the testimony of appellee's experts. The findings of the court are abundantly supported by that testimony, and therefore are not "clearly erroneous."

C. The evidence relating to practical construction of the contract by the parties supports the finding of the trial Court.

In arguing this point, appellant again seeks to place upon a communication from appellee an interpretation that is unwarranted either by the language of the document or the circumstances of its origin. A fair appraisal of the evidence reveals that the court was fully justified in concluding that appellant's conduct in connection with the first price increase indicates that it knew that cost of production, as determined by appellee, included and was intended to include overhead expense and indirect charges. Other reliable evidence, to which the court did not refer in its opinion likewise supports this conclusion.

In August 1941, appellee notified appellant that, effective October 5, 1941, the price of gypsum would be increased to \$2.98 per ton by reason of an 18¢ increase in appellee's cost of production. (R. 3.) On October 1, 1946, a conference on the subject was held between Mr. Colton and Mr. Canvin representing appellant, and Mr. Wallace representing appellee. (Pltf's. Ex. 1, R. 100.) Mr. Canvin was appellant's secretary and treasurer. (R. 103.) It was pursuant to his request that the letter of October 2, 1941, was

written enclosing a "recapitulation of labor, material and power costs which accounts for 15¢ per ton of the 18¢ per ton increase." (Pltf's. Ex. 1, R. 100.)

Referring to the recapitulation enclosed with the letter, appellant states that appellee "supported this increase by a statement of the costs which had increased * * *" (Appellant's Brief, p. 25.) That is a palpable distortion of the evidence. The statement showed on its face that it did not purport to "support" the entire increase. It showed only three items of expense and only 15¢ of the 18¢ increase. These figures were furnished at the request of Mr. Canvin following his conference with appellee's accountant at the latter's office. The letter of transmittal expressly stated:

"If you desire further information in re the attached statement, or in connection with our basis of determining increase in cost, please call on the writer." (R. 100.)

Mr. Canvin knew that the cost of production had increased 18¢. He knew also that the statement showed only three items of cost which aggregated increases of only 15¢. Yet, upon receipt of this statement he did not complain that it was incomplete, nor did he request any "further information" as he had been invited to do. The inference is unavoidable that Mr. Canvin got precisely what he had asked for at the time of the conference, to-wit, a statement only of the items of labor, material and power costs. It is equally apparent that at the time of the conference Mr. Canvin obtained such information as he required

regarding the other items of cost, which the uncontroverted evidence shows included overhead expense and indirect charges. (R. 355.) There is no other logical explanation for his failure to request a statement of all costs upon receipt of the partial statement enclosed with the letter of October 2, 1941.

Appellant in its brief (p. 41) lays great emphasis on the importance which a difference of a few cents in production costs can make over the term of the contract. Yet, it would have this court infer that upon receipt of the statement showing only 15¢ of the 18¢ increase, appellant did not trouble itself about the balance and was content to assume that "the other 3¢ was due to other direct charges of a minor nature", and that "appellant paid the increased price without seeking further detail." (Appellant's Brief, p. 26.) Not only is this completely illogical, but it is unsupported by the evidence. This assertion by appellant is premised on Mr. Flick's testimony that it was not until January 1944 that he knew that the first price increase involved anything other than direct charges. (R. 105; Deft's Ex. A, R. 351-357.) But Mr. Flick did not become affiliated with appellant until July 1942. (R. 95.) He testified that he did not even see the letter of October 2, 1941, until some time in 1943. (R. 99.) Whatever assumptions he may have entertained in 1943 or thereafter are of no significance. There is no evidence that when appellant received the letter and statement of October 2, 1941, and thereafter paid the \$2.98 price, it assumed that the 18¢ increase was based only on direct charges. On the contrary,

the evidence hereinabove referred to compels the conclusion that Mr. Canvin knew that the 18¢ increase in cost of production included overhead expense and indirect charges, and that the payments of the \$2.98 price thereafter were made with knowledge of that fact.

The evidence is undisputed that in calculating the first price increase appellee included overhead and indirect charges in cost of production. (R. 355.) Such being the case, it cannot very seriously be contended that by its conduct appellee construed the contract as excluding those charges. Nor is there any reasonable basis upon which to infer that because Mr. Canvin requested a statement of three items of direct cost, and because appellee furnished what was requested, appellee thereby construed the contract to mean that "cost of production" included only direct costs.

It is readily understandable from the above why the trial court, in concluding that the contracting parties intended "cost of production" to include all costs, stated that the "parties' conduct with reference to the first price raise supports this conclusion." (R. 72.) It might very well have drawn the same conclusion from the conduct of appellant in other regards. It will be recalled that notice of the second price increase was given in January 1944. (R. 3-4, par. 7.) By that time Mr. Flick had become controller. (R. 95.) He requested a detailed statement of the cost figures in connection with the second price increase and for the first time requested a similar statement

as to the 1941 increase. (Deft's Ex. B, R. 347-349.) Appellee promptly furnished both statements (Deft's Ex. A, R. 351-356), notwithstanding that the first price increase had been an accomplished fact for several years. There was no evasion, delay or reluctance whatever on the part of appellee to furnish a detailed statement of the first increase, such as might have been expected if the partial statement rendered in 1941 had been intended to indicate that the increase was premised only on increases in "direct" cost of production.

Notice of the third price increase was given on September 13, 1946. (Pltf's Ex. 10, R. 219-221.) Shortly thereafter Mr. Flick sent Mr. Bannard, a certified public accountant, to appellee's office to inspect its records and report back to him. (R. 231, 417.) Mr. Flick testified that Mr. Bannard "was thoroughly familiar with my position in respect to all of these accounts." (R. 416.) Mr. Bannard made the inspection and prepared a work sheet upon which he noted all items of cost as shown by appellee's records, and on which he noted all adjustments thereof that he considered should be made. (Deft's Ex. D, R. 419.) Appellee's books showed an increase of 7¢ per ton in overhead. Mr. Bannard made adjustments in three minor items included in overhead. However, with full knowledge of Mr. Flick's position on the subject, he made no adjustment in or objection to overhead, as such, and the ultimate increase of 7¢ per ton remained unadjusted on his work sheet. (R. 419, 432, 434-436.)

At page 26 of its brief, appellant improperly refers to the 1944 statement of costs relating to the 18¢ increase as a “corrected account.” There is no inconsistency between this complete account rendered at the request of Mr. Flick and the partial statement rendered in 1941 at the request of Mr. Canvin. Except for a difference of one cent in power cost in the 1940-1941 period, which probably results from a rounding off of decimals, the figures shown in the 1944 statement for the three items covered by the 1941 statement are identical, as the following recapitulation demonstrates:

	<u>1941 Statement</u>	<u>1944 Statement</u>
Period 1939-40	(R. 100)	R. 355)
Labor .....	.30	.30
Materials .....	.12	.12
Power .....	.11	.11
Period 1940-41		
Labor .....	.32	.32
Materials .....	.22	.22
Power .....	.14	.13

Appellant states that the form of the 1941 letter and statement were not such as to put appellant “on notice that indirect charges were being included.” (Appellant’s Brief, p. 27.) There is nothing in the contract requiring appellee to put appellant “on notice” or even to furnish a statement of cost of production. The contract provides only that appellee’s records “shall be open to inspection” of appellant. (Par. (6), R. 11.) This is a privilege of which appellant has freely availed itself. Even if it were not a fact that, as the evidence indicates, Mr. Canvin ascertained that “in-

direct charges were included", it still would not change the fact that such charges have been included by appellee in determining cost of production ever since the inception of the contract. Hence, there is no validity to the argument that appellee, by its conduct, has construed the contract to exclude overhead and indirect charges. The reliable evidence is all the other way.

- D. The fact that the contract provides that price increases shall be based on "actual advance" in appellee's cost of manufacture, does not require the exclusion of "indirect" costs.**

Appellant's argument of this point is merely a variation of its basic contention, which was rejected by the trial court, that overhead and indirect charges are not includable in cost of production because they must, of necessity, be allocated and therefore are not precisely provable in amount. We have already shown that the evidence fully sustains the finding that in using the synonymous terms "cost of production" and "cost of manufacture", the parties intended the inclusion of all costs, determined in accordance with good accounting practice, and that such costs include overhead and indirect charges. (R. 51.)

It is axiomatic that if cost of production, determined in accordance with good accounting practice in one period exceeds the cost so determined in another period, an "actual" increase has occurred. Webster's dictionary defines "actual" as something that is "factual". Certainly no manufacturer would dispute for a moment that if the salaries of his manager,

superintendents, foremen, clerical help or any other type of general or administrative employee increase, the additional expense is both “actual” and “factual”. These expenses must be paid just as certainly as any “direct” expense and the resultant increase in “cost of production” is painfully “actual”.

The cases cited by appellant construing the term “actual cost” have no application to this case. That is not the language of the contract. The contract refers to “cost of production”. The restriction of price increases to “actual increase” in “cost of production” in no wise controls the method to be employed in determining cost of production and whether an increase has occurred and thereby become “actual”. The question as to whether or not overhead and indirect expense are includable in “cost of production” is to be determined according to what the term means as used in this particular contract. Accordingly, it would serve no purpose to review and further distinguish the authorities cited by appellant. For every case in which it has been held that under the circumstances of the particular case the term “cost” as used in a contract or statute includes overhead or indirect charges, another case may be found in which, under the circumstances of that case, a contrary conclusion has been reached.¹⁹

¹⁹*Fillmore v. Johnson*, 221 Mass. 406, 109 N.E. 153;
Boston Molasses Co. v. Molasses Distributors Corp., 274 Mass. 589, 175 N.E. 150;
Fort Dearborn Trust & Savings Bank v. Skelly Oil, 146 Okla. 179, 293 Pac. 557.

As stated in *State v. Northwest Poultry & Egg Co.*, 203 Minn. 438, 281 N.W. 753:

“ ‘Actual cost’ has no common-law significance, and it is without any well understood trade or technical meaning. ‘It is a general or descriptive term which may have varying meanings according to the circumstances in which it is used.’ * * * Its meaning may be restricted to overhead or extended to other items. * * * It has been used to include overhead, rent, depreciation, taxes, insurance, etc.”

Similarly, in *Finn v. Culberhouse*, 105 Ark. 197, 150 S.W. 698, the court stated:

“It has generally been said in the adjudged cases that such terms as ‘actual cost’, ‘estimated cost’, ‘first cost’, ‘original cost’, ‘prime cost’, and ‘whole cost’ are indefinite, and that surrounding circumstances must often be looked to in order to arrive at a proper interpretation. (Citing cases.)”

Of particular interest is *Myers v. The Texas Company*, 6 Cal. (2d) 610, 59 P. (2d) 132. That case involved an oil lease which did “not obligate the defendant to extract gasoline from the natural gas,” but provided that if it did, lessee should pay lessor one-sixth of the proceeds “after deducting the cost of extraction”. The court observed that the “possible extraction of gasoline was only an incident to the main undertaking,” just as appellant claims that the production of gypsum is only incidental to the production of magnesia. In construing the meaning of the contract the court held that depreciation, insurance, ad-

ministration or bookkeeping expenses and taxes (all of which necessarily were "indirect charges") were properly includable in determining "cost of extraction". The court stated at p. 619:

"* * * * We agree with appellants that the word 'cost' is a word of variable meaning and that it must be construed according to the circumstances in which it is used. A review of the authorities is of little value, except to illustrate the fact just stated that, in order to arrive at the intent with which it was used in the particular case, the word is to be construed in the light of all attending circumstances. * * *"

Thus, in this case the trial court, in light of the contractual language and all attending circumstances, found on substantial evidence that "cost of production" means and was intended to mean all costs, including overhead and indirect charges. Appellant's own witnesses admitted that in the case of a co-product it is usual and good accounting practice to include such charges, even though of necessity they must be allocated and are not precisely determinable in amount. The court agreed with appellee's experts that the same accounting procedure is applicable in this case. It properly concluded that an increase calculated in accordance with good accounting practice is "actual" within the meaning and intent of the contract. These findings are supported by a plethora of substantial evidence, and are not clearly erroneous.

IV.

THE TRIAL COURT PROPERLY FOUND THAT THE DETERMINATION OF COST OF PRODUCTION OF GYPSUM BY APPELLEE FROM TIME TO TIME HAS BEEN IN ACCORDANCE WITH THE PROVISIONS OF THE CONTRACT.

At pages 50 and 51 of its brief appellant has tabulated the items of cost involved in the second and third price increases which it disputes and has indicated the reasons for its objections thereto. In the ensuing argument we will deal separately with each of the disputed items.

A. Plant overhead.

This item is designed as "other overhead" in the tabulation of disputed items. It consists of the overhead at the Newark plant after eliminating all research expense and the items designated as "West Coast" expenses. It is undisputed that the aggregate overhead expense was incurred by appellee and the evidence shows that the allocation thereof to gypsum was made in accordance with good accounting practice. Appellant's objection to this item is based on its extreme position that not even manufacturing overhead is includable in cost of production of gypsum, for the reason that it must be allocated and is not precisely determinable in amount.²⁰ (Appellant's Brief, pp. 27-34.) In our prior discussion, we have shown

²⁰Appellant is not consistent even in this regard. The record shows that taxes and insurance are allocated items included by appellee in cost of production. (R. 276, 557.) Yet, appellant takes no exception to these items. (Appellant's Brief p. 5, Footnote 4; p. 52, Footnote 15.)

that the court was fully justified in finding that, under the terms of the contract, this expense is and was intended by the contracting parties to be included in cost of production, and that good accounting practice compels such inclusion. The evidence not only is sufficient to support the finding, but preponderates in favor thereof.

B. New Products Research.

Appellee's research laboratory is devoted to testing of products, improving processes, working out new analyses, and developing new products to be derived from the raw material. (R. 907-908.) The indirect charges in the laboratory are allocated to the various products produced in the plant in the proportions that the cost of the laboratory services directly and exclusively employed in connection with the respective products bears to the total of such direct charges. (R. 907-908.) In the year 1943, 6.78% of "new products" research, or the sum of \$2,804, was allocated to gypsum, and the sum of \$243 was charged to gypsum on a direct basis. (R. 354.) For the 12-month period ending June 30, 1945, the aggregate charge against gypsum was \$1,194.13 and in the 12 months ending June 30, 1946, it was \$2,622.15. (R. 569.) No evidence was introduced showing the breakdown of these items in the latter periods as between direct and indirect charges. Nor, was there any evidence as to what proportion of the aggregate charges in those periods was for "new products" research and what proportion was for general research, including improvement of processes and

working out of analyses. Although at page 51 of its brief, appellant takes exception to all research charges, whether for new products or not, the only objection argued in the brief is to “new products” research. From this we assume that appellant’s objection to the research charges in the latter periods is upon the broad ground that it is a portion of overhead and is excludable for that reason alone. That objection has been fully covered in sections III and IVA of our argument.

Appellant’s argument against charging any part of new products research expense against gypsum is premised upon the assumption that it is “totally unrelated to gypsum.” (Appellant’s Brief, p. 35.) This assertion is based upon the testimony of Mr. Flick, who, admittedly, is not a chemist. (R. 125.) Appellant likewise relies upon other testimony that is taken out of context and severely strained. Mr. Wallace testified that some research had been conducted as to the possibility of making a different product than gypsum from the sulphate. (R. 1093.) He was asked whether some of that research had been allocated against gypsum to which he replied, “that it very likely could have been.” (R. 1094.) There was no evidence as to the amount expended in this research. In cross-examination of Mr. Alexander he was asked whether the expense of that specific research project “which obviously could in no way benefit the plaintiff in this case” should be allocated against gypsum. He expressed the frank opinion that it should not, but emphasized that

this opinion was restricted, and that “it is that specific thing that I would not allocate.” (R. 1195.) He did not state that new products research, generally, is an improper charge.

Appellant’s reference to the testimony of Mr. Farquhar likewise shows the weakness of its position. He was asked, purely hypothetically, as to whether overhead “wholly disassociated from the manufacture of a particular product” should be charged against such product and he answered in the negative. (R. 1132.) Here again the assumption was that the research charges were “totally unrelated to gypsum” and “wholly disassociated” from the manufacture thereof. There is no evidence to support these assumptions. Every reasonable inference from the evidence is to the contrary.

As has been pointed out, overhead expense and indirect charges at appellee’s plant are allocated among the various products there produced. (R. 276, 557, 558.) The greater the number of products the less is the percentage of these charges to be allocated to each. The evidence shows that a number of new products derivable from bittern have been developed in the research laboratory. (R. 1022.) Thus, it is obvious that the development of new products through the research laboratory operates, costwise, to the benefit of all products produced in the plant, including gypsum. This directly benefits appellant in that the less overhead chargeable to gypsum, the less the cost of production which may result in price increases under the con-

tract. That is what Mr. Williams had in mind in his discussion with Mr. Flick. (R. 175.) At page 35 of its brief, appellant states that Mr. Williams "admitted that appellant's objections to this charge are justified." That is a manifest misinterpretation of the testimony. He did state that he thought appellant was justified in questioning the charge for new products research. Obviously, what he had in mind is that the designation of the account is misleading, because in the next sentence Mr. Williams stated that "the research was for the Newark plant, California, only, and it would result in bringing down the plant cost and therefore ought to be included." (R. 175.)

A good example of how new products research may benefit appellant is furnished in the case of sulphuric acid expense. Upon cessation of production of ethylene dibromide at appellee's plant, sulphuric acid which formerly was charged to the cost of that product had to be charged to gypsum, and that is one of the charges to which appellant takes exception. (See section IV F, *infra*.) Should a new product be developed to use the bromine, it might permit the continuous operation of the bromine plant and eliminate any further sulphuric acid charge against gypsum.

It is a truism of chemical research that one does not expect each experiment to be successful. It is only in the aggregate over a period of time that such expenditures are productive, but it is commonplace that in our system spectacular reductions in cost are the result of scientific research, and this court can take judicial

notice of the fact that research is a necessity in modern technology. It is for that reason and upon the grounds above stated that Mr. Watt and Mr. Alexander approved the allocation to gypsum of a reasonable percentage of appellee's research costs at its Newark plant. (R. 935, 936, 1184.)

C. General and administrative expenses.

As previously mentioned, the accounting sheets comprising Plaintiff's Exhibit 18 were prepared by Mr. Flick. (See Footnote 14, *supra*.) Mr. Watt explained that the designation of "West Coast" expenses as appears at R. 569, is not the designation under which the items are carried on appellee's books. (R. 1049.) He stated that these items constitute "expense incurred in Newark for the Newark plant" and are wholly "unrelated to any other West Coast operation" of appellee. (R. 1049-1050.) A portion of this aggregate expense incurred at the Newark plant is charged to two other plants operated by appellee in California so that the Newark plant bears only its proportion of the total. (R. 930-931.) Appellant's objection to these items is based on the erroneous assumption that they are disassociated from manufacturing operations at the Newark plant. (Appellant's Brief, p. 38.) Mr. Watt's testimony is to the contrary. Consequently, the fact that appellee's witnesses testified that only "factory" or "plant" overhead should be included, does not exclude the items in question.

Mr. Farquhar testified as follows:

“Well, cost of production may have a considerable share of the administrative expense where selling is very little. Going back to my Navy experience, there was no selling expense after the contracts, and all the administrative expense was apportioned as overhead and acknowledged as overhead and paid for by the United States Government, the Navy Department, as part of the cost of building destroyers. There was just a minute amount left for selling.” (R. 1132.)

In the instant case, substantially all of the gypsum manufactured is sold to appellant under the contract and there is no selling expense whatever. Accordingly, the inclusion of the general and administrative expenses designated as “West Coast” is entirely consistent with the testimony of appellee’s experts and is expressly approved by the above testimony of Mr. Farquhar as well as that of Mr. Alexander. (R. 1183, 1192.)

What has been said applies equally to the item designated “West Coast, New York Office”. Having in mind that the Newark plant of appellee is one of a number of plants throughout the country, it is obviously not a completely integrated unit. The evidence shows that appellee maintains four floors of offices and 150 employees in New York. (R. 1081.) It must be assumed that this expense is not incurred unnecessarily, and that the general supervisory services thereby rendered are both necessary to and beneficial in the operation of the manufacturing processes conducted at the Newark plant. The evidence shows that

in the period 1945-1946, the aggregate amount allocated to gypsum for New York office expense was \$671. There is no evidence that this charge was excessive or that the services of the home office were not necessary to the operation of the Newark plant.

We submit that the inclusion of these general and administrative expenses is supported both by the evidence and by common sense.

D. Indirect shipping and air compressor charges.

Mr. Watt pointed out that as to indirect shipping expense the allocation was changed from use of a value basis to a tonnage basis for the very obvious reason that the volume of a product that is handled and shipped, rather than the value, is the true measure of the labor and expense that is involved. (R. 958.) As he stated, "the truth of shipping is the tonnage that is shipped." (R. 959.) As to the air compressor charge, he explained that this had previously been included in general overhead, but was changed so as to allocate the expense among the products produced according to a study made by the maintenance department as to the respective times that the compressor was used directly in the handling or production of the various products. (R. 1006-1007, 1009-1011.)

The evidence shows that appellee has employed the same accounting procedures with regard to gypsum as have been applied to the other products produced at the Newark plant. (R. 910, 929.) Mr. Watt stated that these accounting changes were not adopted for the purpose of giving gypsum adverse accounting

treatment or even with a view as to what the future effect on gypsum cost would be. (R. 957-958.)

They were made to refine or improve the methods previously employed in order to arrive at a more accurate result in segregating the charges. (R. 958, 1010.) Accounting is not an exact science but one that is based on judgment and experience. As stated by Professor Jackson, it is supposed to be "good common sense." (R. 1210.) It must have been contemplated by the businessmen who negotiated this contract that accounting techniques would not remain static during the 25 year term of the agreement.

At the time the contract was entered into the parties agreed to leave the determination of cost of production to the accountants, and that such cost be determined in accordance with good accounting practice. In our opinion the accounting changes that were adopted were consistent with this general understanding and intent. The trial court was of the same view. Should this court feel otherwise, the adjustment of 3¢ per ton from November 13, 1946, readily may be made without the necessity of any further proceedings.

It is pure coincidence that the 3¢ involved in these two items is the same amount that appellant now states it considered so insignificant in connection with the first price increase that it was willing to assume in that instance that "it was due to other direct charges of a minor nature", and which appellant was willing to pay "without seeking further details." (Appellant's Brief, p. 26.) Appellant attaches much greater im-

portance to the amount when it serves its purpose to do so. (Appellant's Brief, p. 41.)

The only other change in accounting methods referred to by appellant is with reference to the allocation of overhead expense. (Appellant's Brief, p. 42.) There is no evidence that this change resulted either in an increase or decrease in the cost of producing gypsum.

E. Straight line depreciation.

Ever since construction of its plant appellee has calculated its annual depreciation charges on a "straight line" basis whereby the cost of equipment is charged off in equal annual amounts over the term of its estimated life. (R. 440, 902.) Mr. Alexander testified that this is the "best way of determining depreciation that we have before us in most cases." (R. 1184.) Appellant admits that the method is a "common one" and is "widely used". (Appellant's Brief, pp. 46, 48.) However, it argues that straight line depreciation is "hypothetical or theoretical" and that for the purpose of this contract appellee should base its annual depreciation charge on the "amount of gypsum that could be produced over the total life of the machinery." (Appellant's Brief, p. 46.)

This argument is purely one of convenience and self-interest. It is without support in the record and has nothing to commend it except that the production method would result in an advantage to appellant. The uncontradicted testimony shows that the only true measure of depreciation that occurs in the gypsum

plant is the time element rather than the quantity of gypsum produced. The predominant cause of depreciation is the corrosion that normally attacks machinery in a chemical plant. (R. 901-902, 1184-1185.) There is no "variance in the corrosion or wearing of equipment according to the quantity of production produced in it." (R. 901.) Mr. Alexander explained the matter as follows:

"It (the gypsum plant) is not to be compared with a machine tool where a good industrial engineer would perhaps estimate it would produce so many items. Not this equipment. From all the information I could gather, it wears out on a time basis which calls for what has been spoken of—it has been used in this courtroom—straight line depreciation." (R. 1185.)

Appellant argues that "the equipment does not wear out faster because less tonnage goes through it." (Appellant's Brief, p. 47.) The significant fact is that the equipment will not last any longer notwithstanding that "less tonnage goes through it." The corrosion will necessitate replacement of the plant in a certain number of years regardless of the tonnage of gypsum that is produced. Obviously, therefore, depreciation charges computed on the basis of the life of the equipment will most reliably "reflect the actual wearing out" thereof and is best calculated to accumulate in the depreciation reserve an amount sufficient to replace the equipment at the end of its useful life. There is no evidence to the contrary, except the hypothetical testimony of appellant's expert witnesses. However, the corrosion factor was not

brought to their attention and was not considered by them in their testimony. Appellant's witness, Mr. Webster, admitted that the depreciation method to be employed in a particular case "is not strictly an accounting problem" but depends "to a large degree on the circumstances." (R. 514.) The only subjective testimony in the record proves that under the circumstances of this case straight line depreciation is the most reliable method.

The crux of appellant's criticism of straight line depreciation is that because the depreciation charges are in equal annual amounts the per unit charge will fluctuate with variations in the quantity of gypsum produced. That is not a valid objection. It is merely the inescapable consequence of the employment of a sound accounting procedure. It is plain common sense and a general economic principle that cost of production will vary according to the quantity of product produced. The greater the volume of production during a fixed period, with other conditions remaining the same, the less the unit cost. There is no way of avoiding the operation of this natural law. (R. 1188.) It applies not only to depreciation, but operates as well upon other charges, whether of a direct or indirect nature. Thus the amount of taxes and insurance per unit of production will vary inversely according to the quantity produced, even though the dollar amount remains the same. This is equally true of superintendence. And in a manufacturing process that is largely automatic, such as this one is, it probably would take as much direct labor

to produce 20,000 tons of gypsum per year as it would 30,000 tons. Hence, even as to this direct expense an increase in per unit cost will result when there is a decrease in the quantity of production. And if there were a decrease in wage scales, this could be true even in the event of a decrease in the dollar amount of direct labor. The fact that depreciation cost per unit will fluctuate according to the quantity of gypsum produced, in the same manner as will other expenses, does not require that this charge be computed according to a formula that constitutes a departure from usual and proper accounting procedure, and which is not calculated to depreciate the property over the term of its estimated life.

Appellant's claim that straight line depreciation is "hypothetical or theoretical" is equally devoid of merit. There is no evidence that the aggregate production capacity of the gypsum plant can be estimated with greater accuracy than can its life in terms of years. Regardless of the amount of production the gypsum plant will withstand the onslaughts of corrosion only for a certain number of years. Consequently, in order to arrive at an annual depreciation charge by the production method, it would be necessary to estimate the quantity of gypsum that will be produced by appellee during those years. The evidence shows that there have been substantial variations in the volume of gypsum produced by appellee during different 12-month periods in the past. (R. 565.) What amount will be produced in future years is particularly conjectural in that under the contract appellant may re-

duce its purchases to 20,000 tons per year, or may cancel the contract entirely. Certainly there is no evidence or reason to assume that depreciation calculated on estimated production during estimated life would be less “hypothetical or theroetical” than depreciation based only on estimated life. We fail to see how the introduction of two estimated factors in a depreciation formula can result in greater certainty than a formula that involves only one such factor.

Appellant has entirely misconstrued the holding in *McCardle v. Indianapolis Co.*, 272 U.S. 400. The Supreme Court did not condemn the charging of annual depreciation on a straight line basis. The question before the court was the determination of the present value of the utility property for rate-making purposes. With reference to the depreciation that had accrued at the time of the inquiry, the court stated:

“The testimony of competent valuation engineers who examined the property and made estimates in respect to its condition is to be preferred to mere calculations based on averages and assumed probabilities.”

For the same reason that the Supreme Court rejected a calculation on the straight line basis for the purpose of determining accrued depreciation, it would also reject a calculation made on the production method. It would accept the testimony of competent engineers who had examined the property and observed the depreciation that has occurred in preference to a mere calculation made on either basis

The evidence conclusively shows that under the circumstances of this case the straight line method of depreciation is the only reliable basis upon which to charge off the gypsum plant and create a reserve adequate to replace the property at the end of its useful life. There is no conflict in the evidence in that regard. The extent of the testimony of appellant's witnesses was that the production method would be more advantageous to appellant. They did not state that it would reflect the wearing out of the plant. There is nothing in the contract or the evidence that requires a departure from this usual accounting procedure that has been employed by appellee consistently throughout the years. The trial court had no alternative but to approve straight line depreciation.

F. Sulphuric acid.

Appellant objects to the charge of 23¢ for the sulphuric acid that first occurred in the period of July 1, 1945, to June 30, 1946. (R. 565.) It contends that this charge resulted from a change in accounting methods. That is not true. The fact is that the charge appeared for the first time in this period because of a basic change in the manufacturing processes at the Newark plant.

Operations at the Newark plant commenced in 1930 or 1931 at which time the bromine unit constituted the entire plant and bromine was the only product produced. (R. 743.) From the inception of operations and when bromine was the sole product sulphuric acid

was used in its production. Naturally the cost of the acid was charged to bromine. (R. 832.)

The gypsum and magnesia plants were constructed in 1937. (R. 747.) When the three plants are in operation the bittern passes first to the bromine plant, then to the gypsum plant, and finally to the magnesia plant. Defendant's chemist, Mr. Melhase, explained that when the bromine plant is operated sulphuric acid is necessary to improve the chlorine efficiency to enable the recovery of bromine. (R. 808.) The function of the acid in the production of gypsum is to decrease the amount of organic material and alter the size and shape of the gypsum crystals to facilitate further processing. (R. 808.) As the result of a test that was run in appellee's plant in which an attempt was made to produce gypsum without adding sulphuric acid to the bittern, it was determined that the product could not be satisfactorily dried due to the absence of the acid. (R. 809.) Sulphuric acid is not necessary to the production of magnesia; the magnesia that was produced during the period that the above test was run proved to be satisfactory notwithstanding the absence of the acid. (R. 808, 1247-1248.)

Ever since the commencement of operations at the Newark plant it has been the consistent accounting procedure to charge the sulphuric acid against bromine, when that product was being produced. (R. 926.) However, the production of bromine was discontinued in September 1945, and from that time on the sulphuric acid was charged to gypsum, except for a brief period in 1946 when bromine production was

temporarily resumed. (R. 926-927.) It is established by reliable evidence that sulphuric acid is necessary to the production of gypsum but is not necessary for magnesia. Obviously, when the production of bromine was discontinued it was entirely proper, indeed, it was essential, to charge the expense of the acid against gypsum which then became the only product in production that required the acid for its manufacture. In the entire history of the company there has never been a charge against magnesia for sulphuric acid. (R. 927.)

It is readily apparent from the above that the fact that the sulphuric acid charge against gypsum first appeared in the 1945-1946 period resulted from a basic change in the operating conditions at the plant rather than from a change in accounting procedure. It was a new charge to gypsum necessitated from this change in circumstances. The propriety of the charge is substantiated by the testimony of appellant's witnesses, Messrs. Pryor and Webster. Mr. Pryor stated that there is nothing wrong in including "a new expense" that did not occur in a previous period. (R. 687.) He conceded that the sulphuric acid charge might have resulted from a change of circumstances rather than a change of accounting practice. (R. 707.) Mr. Webster testified that a new expense that arises in the course of the manufacture of a product by reason of a change in circumstances that did not exist in a prior period would, as a matter of accounting, represent an increase in the cost of production in the second period as compared to the first;

he conceded that if the sulphuric acid were used only for the purpose of producing gypsum it would be a proper charge to gypsum. (R. 513, 549.)

With relation to other items entering into cost of production, appellant has insisted that accounting methods must be consistent. In this instance, however, it is equally vociferous in asserting that appellee should depart from the accounting procedure that it consistently employed from the very inception of its operations. It cannot be denied that it would be highly improper to charge any portion of the sulphuric acid to magnesia, for the production of which it is unnecessary. It must be conceded that as a basic raw material it must be charged somewhere, and when bromine is not produced there is no place to charge it other than to gypsum, the only product for the production of which it is required.

In light of the evidence, we submit that the trial court was fully justified in approving the sulphuric acid charge.²¹

G. Bittern.

Although this is one of the items to which exception is taken at page 51 of its brief, appellant has not undertaken to argue the subject, probably for the

²¹In footnotes 3 and 14 of its brief, appellant has assumed to refer to the fourth price increase which occurred since the entry of judgment. We submit that this is highly improper. Inasmuch as the details and facts pertaining to this increase are not a part of the record, it would be purposeless to discuss the subject and we do not propose to be lured into argument of any matter that is not properly before the court.

reason that in connection with the last price increase there was a reduction of 2¢ per ton in this item. (R. 565.) It appears to us that it is obvious on its face that gypsum should bear some part of the cost of the very raw material from which it is derived. Naturally, there is no precise basis upon which to determine the amount of bittern utilized in the production of each of the various chemical products extracted therefrom. Consequently, a certain "arbitrary" percentage of the bittern cost has been allocated to gypsum. (R. 927-928.) This percentage has been consistent throughout the term of the contract. (R. 1057, 1059-1060.) The evidence sustains this as good accounting practice.

V.

APPELLANT HAD THE BURDEN OF PROVING THE ALLEGATIONS OF ITS COMPLAINT.

Appellant asserts that the court below reached its decision that appellee had properly determined cost of production upon the ground that appellant had failed to prove that appellee's records were improperly kept, and that the price increases were unjustified. (Appellant's Brief, p. 52.) This is only partially true. It expressly appears from the foregoing discussion that the court based its decision also upon convincing evidence that the parties intended, and good accounting practice requires, that overhead and indirect charges be included in determining appellee's cost of producing gypsum. The court stated in its opinion that it was "clear to the court that when the

parties used the term 'cost of production' they intended it to include all costs that might be shown by accepted accounting practice"; and that the evidence showed that under accepted accounting practice it is proper to "charge to a by-product a proportionate share of indirect and overhead as well as the direct costs." (R. 72-73.)

The fact is that it cannot be ascertained from the record to what extent the trial court felt that appellant had the burden of proof. Throughout the trial of this case, appellant assumed the prerogatives and accepted the benefits of the party having the affirmative of the issue. Both in the presentation of evidence and in written and oral argument appellant both opened and closed. (R. 1170.) The trial commenced on December 8, 1947. It was not until December 23rd that appellee had the opportunity to commence presentation of its evidence. (R. 742.) In the interim, appellant produced its witnesses who testified at great length on all phases of the case, and introduced 20 written exhibits. After appellant had completed its case and appellee was about to present its proof appellant for the first time mentioned the subject of burden of proof. (R. 737.) However, the court was not asked to rule upon the point at that or any subsequent time.

It is our position that both on the general question as to whether overhead and indirect charges are includable, and also as to the specific accounting items in dispute and the matter of sampling, the burden of proof was upon appellant.

It was alleged in appellant's complaint that appellant paid appellee at the price of \$3.76 per ton for all gypsum delivered under the contract between September 4, 1946, and November 12, 1946, and at the rate of \$4.48 per ton for gypsum delivered from November 13, 1946, to and including January 31, 1947. (R. 4-5.) Referring to the price increase to \$3.76 per ton claimed by appellee, appellant alleged in paragraph 7 of its complaint that appellee's cost of production of gypsum "had so increased not more than 29¢ per ton" during the period in question and, therefore, that appellee "was entitled to be paid not more than \$3.27 per ton for gypsum delivered under said contract on and after March 15, 1944"; that as to the payments made by appellant at the rate of \$3.76 per ton, such "payments were in excess of the price properly chargeable by defendant under said contract by not less than 49¢ per ton, or a total sum of not less than \$2,494.59." (R. 4.)

In paragraph 8 of its complaint, identical allegations, different only as to the respective amounts involved, were set forth with reference to the price increase to \$4.48 per ton, it being alleged that the payments made by appellant to appellee from November 13, 1946, to and including January 31, 1947, were excessive in the "total sum of not less than \$6,911.34." (R. 5.)

In paragraph 9 of the complaint, appellant alleged that appellee had erroneously construed the term "cost of production" as used in paragraph (6) of the con-

tract, and that appellee “through the use of improper accounting and other methods, determined its cost of production of gypsum.” (R. 5.)

Based on these allegations, appellant prayed for a declaratory judgment as to the meaning of the contract, and also for affirmative relief by way of a money judgment for \$9,405.93.

Appellant argues that the burden of proof was on appellee to prove the increases in its cost of production, on the ground that appellant’s allegations were negative in form and the allegations in appellee’s answer were in the affirmative. (Appellant’s Brief, p. 58.) It is apparent from a reading of appellee’s answer that the allegations referred to constitute nothing more than a denial of appellant’s allegation that appellee’s cost had increased “not more than 29¢ per ton” and that the denial necessarily was stated in affirmative form in order to avoid a negative pregnant. The fact of the matter is that the charging allegations of appellant’s complaint were in the affirmative. Appellant was in the position of a litigant asserting the affirmative of an issue and seeking affirmative relief. It had paid the increased prices claimed by appellee but claimed that it had overpaid and sought judgment for the alleged excess. Thus, it was alleged that appellee’s cost of production had increased not more than an alleged amount per ton; that appellee was entitled to be paid not more than a specified price per ton during the respective periods in question; that the payments made by appellant were in excess of the price properly chargeable by appellee in an amount of not less than \$9,405.93; and that appellee had de-

terminated its cost of production through the use of improper accounting and other methods. In order to recover the money judgment that is sought, appellant was obliged to prove that its payments had exceeded the amounts payable under the contract. In order to show that, it was incumbent on appellant to prove the amount "properly chargeable" under the contract, and in order to make this proof, appellant necessarily would have to prove not only the meaning of the contract, but also the proper cost figures derivable thereunder. Certainly appellant could not shift this burden of proof to appellee through the simple device of coupling its affirmative claim with a prayer for declaratory relief.

But even if it were true, which it is not, that appellant's allegations were negative in form, appellant, nevertheless, would have had the burden of proving the facts it alleged.

In *Travelers Ins. Co. v. Drumheller* (W.D. Mo. 1938), 25 F. Supp. 606, wherein an insurance company brought suit for a declaratory judgment that it was not liable under an accident policy, the court stated:

" * * * If an insurance company, which, normally, would be defendant in an action to enforce a contract of insurance, desires, for the sake of certain advantages, to initiate the proceeding and to become plaintiff, it must assume the ordinary burdens of a plaintiff. Asking a judgment that it is not liable, it must prove it is not liable. In this case it can do that only by proving the insured did not die from accident."

Section 1981 of the Code of Civil Procedure of California provides:

“The party holding the affirmative of the issue must produce the evidence to prove it; therefore, the burden of proof lies on the party who would be defeated if no evidence were given on either side.”

It cannot be questioned that if no evidence were produced by either party in the trial court, appellant could not have recovered judgment for the excess payments that it allegedly made. It is equally clear that in such event the court would have had no record upon which to find, in accordance with the affirmative allegations of the complaint, that appellee’s cost of production “had increased” not more than the alleged amount per ton, or that appellee “had determined” its cost of production through the use of improper accounting or other methods. It was by the application of this principle that the court in *Roadside Rest, Inc., v. Lankershim Estate* (1946), 76 Cal. App. (2d) 525, 173 P. (2d) 554, held that the plaintiff in the declaratory relief action had the burden of proving the allegations of its complaint.²² To the same effect see *Dunn v. County of Santa Cruz*, 67 Cal. App. (2d) 400, 154 P. (2d) 440.

Thus, it is clear that under the law of California, appellant had the burden of proof, and it is that law which controls the determination of the question.

²²In citing this case at pp. 55 and 56 of its brief, appellant omitted the Court’s reference to that portion of CCP 1981 which states that the burden is on the party who would be defeated if no evidence were given on either side.

(*Cities Service Oil Company v. Dunlap*, 308 U.S. 208; *State Farm Mut. Automobile Ins. Co. v. Smith* (W.D. Mo.), 48 Fed. Supp. 570, 572.) Accordingly the state court decisions cited in appellant's brief have no application. Furthermore, none of the cases upon which appellant relies sustains its position. No authority has been cited by appellant, either state or federal, that holds that in a declaratory relief action the defendant has the burden of proving the affirmative allegations of the plaintiff's complaint. Certainly, none of the cases hold that the burden of proof is on the defendant to prove the allegations of the complaint upon which plaintiff seeks a money judgment.

It is interesting to note that *Travelers Ins. Co. v. Greenough* (1937), 88 N.H. 391, 190 Atl. 129, which appellant states is the leading case on the subject, has been expressly repudiated and held inapplicable to declaratory relief actions under the Federal Statute. That action was brought under the New Hampshire Declaratory Judgment Act. In *Travelers Ins. Co. v. Drumheller*, *supra*, the insurance company brought suit under the Federal Act for a declaration that it was not liable under an accident policy on the ground that the insured died from natural causes. On the authority of the *Greenough* case, the company contended that because the burden of proof as to cause of death would have been on the beneficiary in an action on the policy, the defendant had the burden of proof in the declaratory relief action. The federal court observed that the *Greenough* case turned "upon the law of the New Hampshire Act" and that insofar

as the reasoning of that case would fit the federal statute the court "did not agree with that reasoning." Consequently the court held as follows:

"* * * One who comes into court asking a judgment against another, whether it be a declaratory judgment only or one capable of immediate enforcement, must prove that he is entitled to that judgment. * * *"

In *Reliance Life Ins. Co. v. Burgess* (8 Cir. 1940), 112 Fed. (2d) 234, one of the cases cited by appellant, the court applied the identical principle that obtains in California. There, the insurance company brought suit for a declaratory judgment as to its liability under a double indemnity provision of a life insurance policy. The court held that the burden of proof rested on the plaintiff in the first instance, although perhaps the burden of "going forward with the evidence" shifted from time to time as the trial progressed. The actual holding of the court was as follows (p. 238):

"It is a fundamental rule that the burden of proof in its primary sense rests upon the party who, as determined by the pleadings, asserts the affirmative of an issue and it remains there until the termination of the action. It is generally upon the party who will be defeated if no evidence relating to the issue is given on either side."

Appellant has cited *Thompson v. Baltimore & O. R. Co.*, 59 Fed. Supp. 21, as holding that a defendant in a declaratory relief action may have the burden of proof. The fact is that in that case the court held (p. 28):

“Plaintiffs assert the affirmative of these issues and therefore plaintiffs must carry the burden of proof. That this is a suit for declaratory judgment does not change the rule.”

To the same effect is *International Hotel Co. v. Libbey* (7 Cir. 1946), 158 F. (2d) 717.

In *State Farm Mut. Automobile Ins. Co. v. Smith*, supra, cited by appellant, the decision, as in the *Greenough* case, turned upon the local law of Missouri and the court held, by analogy, that it should apply “the same principles which are applied by the Missouri courts in fixing the burden of proof in eminent domain proceedings.” Under the California law, the burden of proof was on plaintiff. Furthermore, in the *State Farm* case the plaintiff was not asserting the affirmative of the issue or seeking affirmative relief, as was the appellant in this action.

In *Philip A. Hunt Co. v. Mallinckrodt Chemical Works*, (Ed. N.Y. 1947), 72 Fed. Supp. 865, cited by appellant, the court stated that the pleadings should be construed to ascertain which of the parties would suffer an adverse judgment if no evidence were received. In that case, the defendant counter-claimed, alleging patent infringement and sought affirmative relief by way of injunction and damages. Obviously, if no evidence were introduced, the court would have had no basis upon which to issue the injunction or assess damages. Consequently, the court properly held that the burden was on defendant to prove the facts necessary to entitle it to relief. By parity of reasoning, the appellant in this case was obligated to

prove all facts necessary to entitle it to the judgment that it sought, and was obligated to prove the affirmative facts that it alleged.

The only other case cited by appellant is *Lumbermen's Mut. Casualty Co. v. McIver* (S.D. Cal. 1939), 27 Fed. Supp. 702, 110 F. (2d) 323. In the opinion by this court the provisions of Code of Civil Procedure, section 1981 were not mentioned, and the Court seemed to place considerable emphasis on the fact that the allegations of the complaint were affirmative in form—that the minor was driving the car rather than that the adult was not. Even under this holding, appellant would have had the burden of proving its affirmative allegations. And again, the appellant in the *McIver* case was not seeking affirmative relief as was the appellant in the instant suit.

In furtherance of its argument, appellant states that appellee “is the one possessed of complete facts and records as to its costs.” (Appellant’s Brief, p. 53.) If appellant seeks to imply that the facts and records were not available to it, such is not the case. In 1944 appellant reviewed appellee’s figures at the plant. (R. 105, 109.) Appellant made a thorough audit of the cost records in 1946. (R. 413, 921-922.) After the commencement of this action, appellant was offered the opportunity of making a further audit by a certified public accountant, but it declined to go to the expense; it chose instead to indicate on blank forms the accounting information it desired and appellant furnished the information in the form requested. (R. 379-381; Pltf’s. Ex. 18, R. 565-573.) Throughout the

trial, appellant from time to time requested other detailed information which, in every instance but one, was produced by appellee. (R. 855-856, 949, 967, 972-973, 1108, 1171-1172, 1245.) The only exception was the tabulation requested by appellant on December 24th which was not completed or produced prior to the termination of the trial because of the intervention of the holidays. (Appellant's Brief, p. 43.) At no time subsequent to December 24th did appellant ask for the tabulation. It is apparent from the foregoing that appellant had all the facts that it desired regarding appellee's cost of production and there is no basis for the suggestion that appellee alone was "possessed of complete facts and records."

In light of the allegations of the complaint and the authorities hereinbefore cited, we submit that to whatever extent the court considered that appellant had the burden of proof, its position was correct. This is particularly true in light of the fact that throughout the trial appellant assumed the burden as well as all advantages of the party having the affirmative of the issue, and did not give the court timely opportunity to rule on the point. Its contention on appeal is inconsistent with its conduct at the trial.

VI.

THE EVIDENCE SUSTAINS THE FINDING OF THE TRIAL COURT THAT A COMPOSITE SAMPLE OF EACH SHIPMENT OF GYPSUM AFFORDS A FAIR AND PROPER CRITERION OF THE GYPSUM DELIVERED, FOR THE PURPOSES OF PARAGRAPH (5) OF THE CONTRACT.

The contract does not contain any provision that obligates appellee to furnish appellant with samples of the gypsum shipped. It is entirely silent on the matter. Appellant's complaint did not allege the existence of any controversy on the subject. It was appellee's position below, as it is here, that there was no language upon which the court could make a declaratory judgment. (R. 214, 1306-1307.)

There was no evidence that the matter of sampling was ever discussed between the parties. Hence, there was no showing as to the intention of the parties in that regard. The testimony did show that gypsum is a bulk product, that it is fungible in nature, and is received and stored by appellant in quantities aggregating up to approximately 500 tons. (R. 387-388.) The evidence established also that a composite sample of the gypsum shipped affords a "fair criterion of the general quality of the output of the gypsum department." (R. 814.) On the basis of this testimony, the court found that a composite sample of the quantity of gypsum shipped by appellee to appellant in the course of a 24-hour period, affords a fair and proper criterion of the gypsum delivered and that such method of sampling is in accordance with the terms and provisions of the contract. (Finding 16, R. 57-58.) It is our position that if the subject was in issue or

within the purview of the contract, the evidence fully sustains the finding.

Appellant's argument on this point is to the general effect that for a number of years appellee furnished appellant with a sample of each car of gypsum delivered and that this operated as a practical construction of the contract. No authorities are cited and we know of no cases in which it has been held that a gratuitous service rendered by one contracting party to another, in connection with a matter that is not even mentioned in the contract, operates as a practical construction of the agreement to mean that the first party is obligated to continue the service. We fail to see how there can be practical construction of a provision which is non-existent in a contract. As stated in 12 *Am. Jur.* 791:

“Where a term of a contract is lacking, resort may not be had to the acts or conduct of the parties not in themselves amounting to an agreement for the purpose of supplying it.”

We disagree with appellant that paragraph (5) of the contract permits appellant to reject any single carload that is not up to specification. We submit that a far more reasonable interpretation is the one made by the court that the conformity to specifications is to be determined on a per-shipment basis. Hence, if five cars are delivered in a day, it is entirely reasonable to determine the quality of the product by a composite sample representing the shipment. The evidence is uncontradicted that such a sample of this fungible goods affords a fair gauge of the quality. There is no evidence to the contrary.

CONCLUSION.

In *Grace Bros. Inc. v. Commissioner of Internal Revenue*, supra, this court stated that "the burden is upon him who attacks a finding to show that it is clearly wrong". Appellant has failed to sustain this burden in any particular. On the contrary, the reliable and substantial evidence preponderates in favor of the findings of the trial court, both as to the meaning of the contract and the determination of cost of production by appellee pursuant thereto. Consequently, and upon all of the other grounds hereinbefore stated, we respectfully submit that the judgment should be affirmed.

Dated, San Francisco, California,

April 25, 1949.

Respectfully submitted,

CLAUDE N. ROSENBERG,

TADINI BACIGALUPI,

KENNETH RAY,

Attorneys for Appellee.

BACIGALUPI, ELKUS & SALINGER,

Of Counsel.

No. 12,054

IN THE
United States Court of Appeals
For the Ninth Circuit

PACIFIC PORTLAND CEMENT COMPANY, a
corporation,

Appellant,

vs.

WESTVACO CHLORINE PRODUCTS CORPORA-
TION, a corporation,

Appellee.

APPELLANT'S REPLY BRIEF.

MARSHALL P. MADISON,

EUGENE D. BENNETT,

FRANCIS R. KIRKHAM,

WALLACE L. KAAPCKE,

Standard Oil Building, San Francisco 4, California,

Attorneys for Appellant.

PILLSBURY, MADISON & SUTRO,

Standard Oil Building, San Francisco 4, California,

Of Counsel.

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PAUL P. O'BRIEN,

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APPELLANT'S REPLY BRIEF.

**I. THE FINDINGS OF THE TRIAL COURT ARE
"CLEARLY ERRONEOUS."**

It is not correct that, as appellee states (Br. pp. 5, 6), appellant asks this court to try the case *de novo* on the record or argues that the evidence preponderates and is more convincing in favor of appellant's contentions. It is appellant's position, for the reasons stated in its opening brief and in this reply brief, that the findings of the trial court are clearly erroneous within the meaning of Rule 52(a) of the Federal Rules of Civil Procedure, as that rule is applied by the United States Supreme Court and by this court:

"A finding is 'clearly erroneous' when although there is evidence to support it, the reviewing court

on the entire evidence is left with the definite and firm conviction that a mistake has been committed'' (*United States v. Gypsum Co.* (1947) 333 U.S. 364, 395; *Grace Bros., Inc. v. Commissioner of Internal Revenue* (9 Cir. 1949, No. 11,976) 49-5 C.C.H. Federal Tax Service, par. 9181).

The court will have in mind, however, that if it holds the decision below was erroneously based on the conclusion that appellant had the burden of proof (App. Op. Br. p. 52), and even if there were any issue upon which the decision below were not clearly erroneous, the judgment should be reversed as to such issue as well. In that event this court may either order judgment for appellant on the other issues and remand the case for a new trial as to such issue (*Borax Ltd. v. Los Angeles* (1935) 296 U.S. 10, 21), or itself find for appellant upon such issue as well, upon its own consideration of the record (*In Re Gustav Schaefer Co.* (1939) 103 F.2d 237, 242; Cyc. Fed. Proc., Second Ed., 1943, Vol. 12, sec. 6313).

II. CONTRARY TO APPELLEE'S CONTENTION, THE RECORD ESTABLISHES THAT THE CONTRACT HERE INVOLVED EXCLUDES OVERHEAD EXPENSE AND INDIRECT CHARGES FROM THE CALCULATION OF "THE ACTUAL ADVANCE IN [APPELLEE'S] COST OF MANUFACTURE" AND THE RESULTANT INCREASE IN PRICE.

A. The negotiations preceding the contract.

Appellee correctly states (Br. pp. 37-39), quoting *Myers v. The Texas Company* (1936) 6 Cal. 2d 610, 619, 59 P.2d 132, that "the word 'cost' is a word of variable meaning and that it must be construed according to the

circumstances in which it is used.” The contract in suit, moreover, involves more than the interpretation of the bare term “cost” or “cost of production.” It involves the meaning of “cost of production” in the light of the contract’s conclusive recital¹ that gypsum is a “by-product,” and in the light of the contract’s limitation of price increases to an amount “not to exceed the actual advance in [appellee’s] cost of manufacture” of gypsum. In the light of these provisions, we submit it is clear the parties intended that price increases under this contract should be based only upon increases in the direct costs incurred in the production of gypsum.

Appellee suggests (Br. p. 17) that this construction of the contract cannot be accepted because the first draft of the contract (the so-called “Barrows draft” of September 18, 1936) specifically limited price increases to increases in “direct cost” and thereafter the parties rejected the specific term, “direct cost,” and substituted in the final contract the broad term “cost of production.” This suggestion is not correct. The term “direct cost” was used in paragraph 6 of the Barrows draft solely to identify the basis for the initial price of \$2.80 per ton (R. 886), which became the initial price under the executed contract (R. 10). Paragraph 6 of the Barrows draft first

¹Appellee cites two cases (Br. p. 26) to show that this recital is not conclusive. Neither case is in point. *Moffatt v. Bulson* (1892) 96 Cal. 106, 30 Pae. 1022, held simply that a recital of consideration is not conclusive. The statute which provides that the truth of facts recited in the written instrument is conclusively presumed, expressly states this exception (Cal. Code Civ. Proc., sec. 1962(2)). *Taylor v. Lundblade* (1941) 43 Cal.App.2d 638, 111 P.2d 344, holds merely that the recital in an instrument of the time and place of its execution is not conclusive, since the time and place of execution is a “non-essential fact” and “not a material part of the agreement” (p. 640).

states (R. 888, 889) that the stipulated price is based "upon the average direct cost to California to produce the materials covered by this agreement during the first year's operation of the contemplated new plant * * *." It then states that, in the event of advances in certain specific items of cost above "the first year's average direct cost *hereinabove referred to*,"² California may increase the price to the extent of the increase above "*said* average direct production cost." Thus each time the word "direct" was used in connection with costs, it referred simply to the estimated first year's cost on which the original price was based. This draft did not provide that price increases should be based upon "direct cost"; it provided that price increases should be limited to increases in "labor, transportation, fuel or supplies" (R. 889). Absent this limitation, the only words relating to increases are words of general reference to "cost." The parties did not, then, eliminate a specific provision that price increases should be based on increases in "direct costs"; they simply eliminated the specification of four particular items as the costs upon which price increases could be based.

Appellee concedes (Br. p. 19) that there is no testimony in the record that indirect or overhead costs were ever mentioned in conversations between Mr. Colton and Mr. Barrows. It says, however, that this is without significance, dismissing the direct cost method of by-product accounting as involving "ethereal distinctions" which the businessmen who negotiated the contract could not have

²Emphasis throughout this brief is supplied unless otherwise indicated.

had in mind (Br. p. 19). The intensely practical nature of this method of by-product accounting is demonstrated by Dean Jackson's testimony quoted at page 19 of appellant's opening brief that:

“* * * most businessmen would not include as a charge to that by-product that portion of the general overhead which would go on just the same whether the by-product was produced or not. In other words, that product must stand on its own feet as to whether or not it will pay the organization to produce that product from the time it is split off from the main product * * * (R. 1203).

* * * the business would have to determine whether or not, if I may use the figurative expression, they would let the material wash down the sewer or whether they would process it still further, and if they are going to process it still further, then I think that product has got to stand on its own feet and be charged only with the additional expense which would be incurred in the processing of it (R. 1207).”

As Mr. Pryor testified (R. 695-696):

“I think the logic goes back again to my illustration of how a man determines whether or not he is going to process and sell a by-product. If it costs him out of pocket 9 cents to process it, and he can sell it when finished for ten cents, then it is good business to do so, but if by allocating indirect expenses, which would go on anyhow whether or not he was producing that product, and other expenses of an overhead nature which would go on anyhow whether he produced the product, he would have had 2 cents of indirect expense, making a total cost of 11 cents, then he would not produce the product, so it is just common sense that you only charge in mak-

ing up your mind whether to produce or not the amount you are out of pocket for it.”

We do not quote the testimony of these witnesses called by appellant to measure the weight of one accountant’s testimony as against that of another. We quote it to show the businessman’s concept of what it costs to produce a by-product—his practical realization that a by-product is charged only with the direct or out-of-pocket expense incurred in producing it, over and above his general expenses.

In negotiating the contract Mr. Colton and Mr. Barrows—not accountants, but businessmen—were discussing the cost of a by-product—a material that would have been a “valueless waste” but for the factor that appellee’s plant would be located near appellant’s cement plant at Redwood City, giving the gypsum saleability to appellant (App. Op. Br. p. 22). In their discussions of the cost of producing this material these men did not at any time mention indirect or overhead costs (R. 1095, 1096), as appellee concedes (Br. p. 19). The gravamen of their discussions was that Mr. Barrows in his proposals had limited price increases to increases in only a few specific items of direct cost; that he was not willing to be limited to those items when Mr. Colton refused to grant a termination privilege to his company (R. 766); and that other items of cost—but not indirect or overhead costs—were discussed.³ Consequently the limitation of price increases

³Appellant’s brief heavily relies upon the statement in the trial court’s opinion that “it seems clear to the court that when the parties used the term ‘cost of production’ they intended it to in-

to increases in "labor, transportation, fuel or supplies" contained in the Barrows draft (R. 888, 889), was eliminated from the document finally executed. Significantly, however, the parties inserted in the final contract a limitation that does not appear in the Barrows draft—the limitation of price increases to "an amount not to exceed the actual advance in [appellee's] cost of manufacture." Further, and equally significantly, the parties designated gypsum in the final contract as a "by-product," a designation which nowhere appears in the Barrows draft. Moreover, the initial price in the contract was fixed at \$2.80 per ton (R. 10), a price which the Barrows draft shows was based upon the estimated *direct cost* to produce gypsum in the first year of operation of the proposed plant (R. 886, 888, 889).

In this setting of negotiation and drafting, it is conclusive, we submit, that the parties had in mind the method of accounting for the cost of producing a by-product which recognizes its special status and charges it only with the actual direct costs, ascertainably incurred in its manufacture.

clude all costs that might be shown by accepted accounting practice." This statement, however, is founded upon the court's immediately preceding reference (R. 71-72) to "Barrows' testimony, uncontradicted by Colton, that he was unwilling to relinquish his cancellation right and at the same time to limit his costs to those items directly chargeable to the gypsum production * * *."

As shown above, this was not the testimony of Barrows. He testified simply that he was unwilling to be limited to the items of cost enumerated in his proposals. Mr. Colton testified, and his testimony is uncontradicted, that neither Mr. Barrows nor anyone else representing the other party ever suggested to him that any price increase should be based on any items other than direct costs of the manufacture of gypsum (R. 1095-1096).

The general findings of the court below that appellee has determined its costs in accordance with the contract (R. 50-55), rest upon the basic finding (R. 48) that it is unnecessary to find whether or not the gypsum produced by appellee is a by-product, since "good accounting practice requires the inclusion of 'overhead expense' and 'indirect charges.'" These findings erroneously assume (Opinion, R. 69, 72), as does appellee's fundamental argument (Br. pp. 17, 18), that the issue in this case may be resolved merely by determining whether appellee's internal system of accounting, adopted uniformly throughout its own nationwide operations (without any reference to this particular contract or the intent of the parties thereunder), is in accordance with "good accounting practice." But of course that is not the question. The question here is whether the parties to this particular contract intended that the "actual" ascertainable direct costs of producing gypsum at the Newark plant should be the costs used in determining the "cost of production" for the purpose of arriving at price increases under this contract.

The extreme nature of appellee's contention that all indirect items of cost may be added is strikingly illustrated in the events that actually have occurred. Appellant negotiated this contract with California Chemical Company, a local manufacturing concern (R. 742). After the contract was made California Chemical Company consolidated with a number of other companies (R. 771) and then transferred its assets, including its rights and obligations under this contract, to Westvaco Chlorine Products Corporation (R. 748, 771), a large national concern with plants all over

the United States (App. Op. Br. p. 17). This corporation has assigned to the cost of production of gypsum under the contract a portion of its over-all indirect expenses, including "West Coast" overhead expenses and a share in the expense of its New York office—four floors in the Chrysler Building, staffed by 150 employees (R. 1081). Now Westvaco has recently merged with Food Machinery Corporation, and is a division of Food Machinery and Chemical Corporation.⁴ If appellee's contentions are correct, this worldwide manufacturing concern may add still other indirect and even more remote and unexpected expenses to the cost of production of gypsum on the ground that its internal accounting practices provide for the apportionment of such costs to this by-product and experts say that this is in accord with "good accounting practice."

The sum of the matter is that appellee's contentions and the findings of the court below totally ignore the contract's designation of gypsum as a by-product to be produced by California Chemical Company's plant on "Canal Head at Newark, California" (R. 8), and totally ignore the express provision in the contract that price increases shall be limited to "an amount not to exceed the actual advance in [appellee's] cost of manufacture." Nowhere in appellee's brief is there any suggestion that these portions of the written instrument can have any significance whatever if its contentions are adopted. The construction for which appellant contends, on the other hand, is not only in accord with the history of the negotiations between

⁴Appellant expects to move the court for a substitution of parties.

the contracting parties, but also gives effect, as proper principles of interpretation require (Cal. Civ. Code, sec. 1641), to every part of the contract.

B. The practical construction of the contract by the parties.

Appellee's argument as to the effect of the conduct of the parties in connection with the first price increase of October 5, 1941, is based entirely upon speculation concerning disclosures it assumes, without any support in the record whatsoever, were made by appellee to appellant's Mr. Canvin (Br. pp. 31-33, 35-36). Appellee's inferences are directly contrary to the facts indicated on the face of the letter of October 2, 1941, written to Mr. Canvin by appellee's Mr. Hurlburt (App. Op. Br. p. 25). This letter of October 2, 1941, shows that a conference was held between appellant's Colton and Canvin and appellee's manager Wallace the day before it was written, but there is nothing in the record to show what occurred at the conference.⁵

Mr. Canvin, then appellant's secretary and treasurer, died June 3, 1944 (R. 597). His testimony therefore was not available to appellant. Appellee, while now suggesting (Br. p. 33) that Mr. Canvin knew the first price increase of 18 cents included an increase based on over-

⁵The court below was seriously in error in this connection. It is stated in the opinion (R. 70), without any support in the record, that

“While Colton was being shown over the plant, Canvin and defendant's accountant went over the figures.”

The court must have confused the 1941 conference with a visit in 1944, in connection with the second price increase. Then appellant's representatives Flick, Riddell, and Canvin went to the Newark plant, the figures relating to *that* increase were gone over (R. 344), and Flick was shown over the plant (R. 124).

head and indirect charges, made no effort to produce any evidence as to what actually occurred at this conference. Mr. Hurlburt, appellee's chief accountant who wrote the letter of October 2, 1941, was not called as a witness by appellee. Mr. Wallace, who is appellee's western manager and the one who conferred with Colton and Canvin, testified as a witness for appellee but said nothing as to any disclosure made either to Colton or to Canvin. No cost records that appellee supposes were shown to Mr. Canvin were produced by appellee, and the record establishes without conflict that appellant itself has nothing in its files but the letter of October 2, 1941, and the statement that accompanied it (R. 103).

The letter written by Hurlburt to Canvin compels the conclusion that Canvin was not informed of the basis for the price increase at the conference. It begins (App. Op. Br. p. 25), "In accordance with request of yourself and J. H. Colton, while in conference with Mr. Wallace yesterday, we have analyzed gypsum production costs * * *". Plainly, the analysis of gypsum production costs followed the conference and was made pursuant to a request at the conference. Thus it is clear that in the letter of October 2, 1941, and the statement submitted with it, appellant obtained information it had not previously been given—information as to the costs which appellee considered supported the first price increase. Hurlburt's letter further shows that appellee's attention at the time of the first price increase and in the analysis of gypsum production costs referred to in the letter, was confined to direct costs. Neither the letter nor the statement which accompanied it referred to anything but direct cost (R.

100, 101). Appellee intimates (Br. p. 33) that Mr. Canvin knew overhead and indirect charges had entered into the price increase, and that his request was for only a limited or partial statement as to the items of labor, material and power (Br. pp. 30, 31, 33, 35). The letter itself shows this is not true—that what was requested was an analysis of gypsum production costs.

The letter of October 2, 1941, states that the enclosed recapitulation for the two years then compared of labor, material and power costs—only three items of direct cost —“accounts for 15 cents per ton of the 18 cents per ton increase.” Appellee’s subsequent corrected account (furnished in 1944), of the costs claimed to support the first price increase showed that, contrary to this earlier representation, direct costs had increased only 9 cents, and 9 cents of the first increase was based on indirect charges (App. Op. Br. pp. 26, 27). The shift of position indicated by this disclosure is sought to be avoided by appellee’s argument that except for a difference of one cent in power cost in the 1940-41 period, the figures shown in the 1944 statement for labor, material and power were the same as those shown by the 1941 statement (Br. p. 35). This argument is entirely beside the point; if 9 cents per ton of the first increase was based on indirect charges, the 15-cent increase in these three items of direct cost would not “account for” 15 cents of the 18-cent increase.

In appellee’s brief it is twice stated (Br. pp. 32-33) that the evidence is undisputed that in calculating the first price increase, overhead and indirect charges were included in cost of production. The record reference given to support this statement in both instances is only to the

new statement of the 1941 costs, furnished by appellee January 29, 1944 (Def. Ex. A., R. 351-356), after appellee on January 14, 1944, had claimed its second price increase (Plf. Ex. 2, R. 119-121), including a large increase attributed to increases in overhead and indirect charges (App. Op. Br. p. 50).

Appellee also seeks to show that appellant's conduct at the time of the third price increase indicated a recognition of the propriety of basing price increases upon increases in overhead and indirect charges (Br. p. 34). Appellee refers to the fact that in work sheets prepared by appellant's employee Mr. Bannard, upon which he noted the items of cost shown upon appellee's records, and "on which he noted all adjustments thereof that he considered should be made" (Br. p. 34), there was no adjustment excluding the increases in overhead. This is an entire distortion of the record. Mr. Bannard's superior, Mr. Flick, who instructed him as to the examination to be made of appellee's costs, testified "Bannard's job was not to allow or disallow anything. Bannard's job was to go down, look at the figures, and come back and tell me what he found" (R. 416). Mr. Flick further testified that Bannard's work sheet did not represent any final judgment by Mr. Bannard as to what he approved or did not approve. "His work sheets were to enable him to report to me" (R. 417). At the time of Mr. Bannard's examination of appellee's costs, appellant had long since made its objection to price increases based upon increases in overhead and indirect charges (App. Op. Br. p. 5). Following Mr. Bannard's visit, this objection was again promptly stated in appellant's letter to appellee of November 4,

1946 (Plf. Ex. 13, R. 232-238, 241-244), which was approved by Mr. Bannard before it was sent (R. 417). Obviously no "practical construction" by appellant, accepting price increases based on overhead and indirect charges, can be inferred from anything that occurred in connection with Mr. Bannard's fact-finding examination of appellee's accounts.

C. The expert testimony.

Since the term "cost" or "cost of production" is one of variable meaning, depending upon the circumstances in which it is used, and since it is clear on the face of this contract and from the history of the negotiations that the parties intended a limited concept of "cost of production" for use in calculating price increases, the testimony of experts as to generally applied principles of accounting for the cost of manufactured products at large is not determinative. The accountants were not seeking to interpret this particular contract, nor did their testimony contemplate its particular language or the background of its negotiation.

It is unnecessary to consider the extent to which some of the accounting experts would prefer an all-embracing concept of cost of production. The testimony of appellee's accounting experts was that one method of accounting ignores a by-product's special characteristics and treats it as though it were a major product or co-product. But the same experts also agreed that another well-known and widely practiced method of by-product accounting (the method considered preferable by the experts who testified for appellant) recognizes that a by-product is

produced incidentally to the production of the principal product for which the overhead and indirect charges would be incurred in any event, and realistically charges to the cost of the production of the by-product only the direct costs—the costs ascertainably incurred because of its production (App. Op. Br. pp. 19-21). This contract states that appellee's Newark plant was "primarily designed to produce magnesium oxide in its various forms, which plant will produce as a *by-product* substantial quantities of gypsum * * *" (R. S). This recital can mean only that the latter method of accounting is the one that was contemplated by this contract and is the practical method which the practical businessmen negotiating the contract had in mind.

Appellee's disregard of the intent of the parties to this particular contract is illustrated by its repeated reference (Br. pp. 2, 27) to the accounting methods used by appellant at its Gerlach plant. As we have previously pointed out (App. Op. Br. p. 37) no by-product is produced in this Gerlach plant; and of course appellant's calculations for its own internal purposes of the cost of the joint products produced there has nothing to do with the accounting methods that are proper under this contract for the purpose of calculating price increases within the limits that the parties intended.

Appellee attacks as unsupported by the record (Br. pp. 26, 27) the statement by appellant (App. Op. Br. p. 20) that the independent accountants called by appellee recognized that the exclusion of overhead and indirect charges from cost of production of a by-product is an accepted and widely practiced method of accounting—

indeed, the method most commonly found in practice. This attack is unwarranted. Appellee refers to the most common procedure in the case of a by-product as the keeping of no cost records at all (Br. p. 27). This, of course, cannot be said to be a method of accounting for the cost of production of a by-product. Appellee's expert Farquhar did testify (R. 1119, 1120) that where the cost of production of a by-product is determined, the most common practice is to start figuring the cost of the by-product at the point of separation from the material going into the main product. Asked whether no distinction were drawn in cost accounting between a by-product and a co-product of primary product, Farquhar answered that in his opinion no such distinction should be drawn in theory, but admitted it frequently is drawn in practice (R. 1119):

“In theory, no. In practice, frequently.”

Again, asked whether the more usual practice does not confine the by-product costs to those incurred after its separation from the main product, he said (R. 1120):

“* * * I could think of more instances where they do not refine the costs than where they do.”

Although appellee's expert Maxwell sought to equivocate on this question, his cross-examination brought out that the principal authority he cited in support of his views—“The Cost Accountant's Handbook” (R. 1145)—recognized this method of by-product cost accounting (R. 1156, 1161-1166). Indeed, in discussing the method for which appellee contends—the allocation of overhead and indirect charges to a by-product—this text states “that there is no logical basis for this view, except the fact that a cost is attached to each product” (R. 1166).

D. The unreasonable result of appellee's interpretation.

Appellant has pointed out (App. Op. Br. p. 16) that appellee's interpretation would give it price increases more than three and one-half times the advance in its total asserted cost since 1938, the first full year of the Newark plant's operation, and would give it a profit of eight times the initial profit. Appellee says the use of the year 1938 is "particularly odious" (Br. p. 9). That year was used because the Barrows draft of September 18, 1936, shows the initial contract price of \$2.80 per ton was based on the estimated cost during the first year's operation (R. 888, 889). Appellee prefers a comparison of cost in the twelve-month period ending June 30, 1940, with the cost in the last accounting period (Br. p. 9). It thus conveniently selects the year of lowest cost to compare with that of highest cost (R. 565). Even this comparison does not produce a figure that is equal to the total of the price increases claimed. In any event, this comparison is invalid. This lowest cost year ending June 30, 1940, did not in any way figure in the shaping of the contract, as the first year of operation definitely did; nor has the relationship between the lowest and highest cost years anything whatever to do with the operation of the "escalator" provisions of the contract, which move only upward, not downward.

Appellee stresses the unusual features of paragraph (6) of the contract—that its escalator provisions are not related to the cost of production in any base period and price increases are determined by comparing the cost in any twelve-month period with the immediately preceding twelve months (Br. p. 8). We agree with appellee that

this unusual feature of the contract must be borne in mind in the consideration of this case. Because of this feature, and because of the further feature that paragraph (6) operates only upward, not downward, this contract is different in a most essential respect from the familiar "cost-plus" contract under which prices fluctuate up and down as cost of production varies. If this were a "cost-plus" contract, appellant would not be faced with the serious prejudice to which it is subjected by the error of the court below, for inaccuracies in computing increases would be offset when decreases occurred. Under the contract that was executed, however, the error of the court below would permit the pyramiding of improper increases, ever upward, to a point where appellant would be forced to terminate the contract.⁶

Appellant does not complain of these unusual features of the price clause in the contract. It does urge most emphatically, however, that the practices followed by appellee and approved by the decision of the court below are highly prejudicial, since they result in erroneous increases that are permanently fixed in the price, and produce an unreasonable and oppressive result that clearly could not have been intended by the contracting parties.

⁶Appellee contemplates with equanimity the prospect that appellant may be forced to terminate the contract, and regards this as a complete remedy (Br. p. 6). This overlooks the very obvious fact that such termination would subject appellant to the major dislocation of its business consequent upon the loss of a long-term supply of substantial quantities of the gypsum it needs.

III. REPLY TO APPELLEE'S ARGUMENT WITH RESPECT TO THE PARTICULAR ITEMS OF COST (BRIEF FOR APPELLEE, PAGE 40 ET SEQ.).

A. Plant overhead.

What we have said demonstrates, we submit, that no indirect items of expense, including general plant overhead, may enter into the calculation of price increases under this contract. This is true, also, of other items hereinafter discussed. As to these items, however, additional considerations are present (as we showed in our opening brief) and we turn now to appellee's discussion of these items.

B. New products research.

It is simply an obvious fact that research upon new products is not a cost of production of gypsum (App. Op. Br. pp. 34-35). One need not be a chemist or an accountant to perceive this. Appellee's suggestion (Br. pp. 44-45) that this court can take judicial notice of the fact that research is a necessity in modern technology, is irrelevant. However necessary or desirable research upon new products may be to appellee's business, the expense of such research is merely one of appellee's general expenses of doing business, and is not a cost of *production* of gypsum.

Appellee seeks to show a benefit to gypsum from "new products" research by urging that if new products are developed, such new products may bear some portion of appellee's overhead (Br. pp. 43, 44). This, of course, is immaterial to the purposes of this contract, under which price increases that once take effect are not eliminated when cost goes down.

Regarding appellant's objection to that portion of the third price increase based upon a claimed increase in the cost of research, including "new products" research, appellee states (Br. p. 41) that there was no evidence as to what portion of the aggregate charge was for "new products" research. The reason for this is that appellee would not disclose that segregation. The court will note that the account headings on the accounting schedule which shows the breakdown of appellee's charges for overhead (R. 569) separately list "Research" and "Research, New Products." In filling in this accounting schedule, appellee grouped these items together by inserting a bracket, and inserted only a gross figure covering both items. The record does show that all but a nominal amount of the research charge involved in the second price increase was for "new products" research (App. Op. Br. p. 35; Appellee's Br. p. 41). Since appellee would not divulge the extent to which "new products" research contributed to the aggregate research charge involved in the third price increase, it may be inferred that the same was true as to the third increase also.

In any case, the cost of research should be excluded from the calculation of price increases for the same reasons as call for the exclusion of other overhead charges, and for the further reason that research, whether upon new products or otherwise, is not an expense of *production*. To the extent the research charge includes the cost of research upon new products, it must *a fortiori* be eliminated.

In other respects also appellee comments upon the absence of evidence as to the breakdown of the research

charge involved in the third price increase (Br. pp. 41, 42), including the absence of evidence as to the amount charged to gypsum on account of the research project seeking to eliminate gypsum. These further breakdowns, of course, are peculiarly within the knowledge of appellee and could not have been provided by appellant since appellee would not give, as to the third price increase, even a segregation between research and "new products" research.

C. General and administrative expenses.

We need not repeat the evidence recounted in appellant's opening brief (pp. 36-38) and the testimony of appellee's own accountants there discussed which requires the exclusion of this group of expenses from the calculation of price increases.

The accounting schedule of appellee's overhead charges shows a group of items designated as "West Coast" expenses (R. 569). Seeking to show that these expenses are not what this designation indicates, appellee says (Br. p. 45) that the accounting sheets comprising Plaintiff's Exhibit 18 (including this overhead schedule) were prepared by Mr. Flick. What Mr. Flick did was simply to write in the headings and account titles he took from the headings and account titles furnished him by appellee (R. 584, 115). The classifications appearing on these schedules follow appellee's classifications (R. 584) and were made pursuant to classifications previously given by appellee. Appellee so stipulated at the trial (R. 588). Appellee adopted the forms thus prepared for the purpose of furnishing appellant information as to

its costs, and filled in the figures and other matter appearing upon the schedules in light handwriting as distinct from the dark handwriting that is Mr. Flick's (R. 584, 585).

Appellee now states (Br. p. 45) that the designation of "West Coast" expenses is not the designation under which the items are carried on appellee's books. If this is true, it is irrelevant. It is the true nature of an expense, and not the designation given to it upon appellee's books, that controls. In its effort to disguise the true nature of these "West Coast" expenses, appellee lifts from its context a fragmentary portion of the testimony of its office manager, Watt (Br. p. 45). All of Watt's testimony on this subject taken together leaves no question that these items are general expenses of appellee's West Coast operations. He testified that the expenses designated as "West Coast" expenses on the accounting schedule relating to overhead (R. 569) are "expenses pertaining to the West Coast operations" (R. 930). These operations embrace the Newark plant, the Chula Vista plant and Hollister mine (R. 930). The "West Coast General Expense" shown on this accounting schedule is, for example, a portion of West Coast general expense allocated to Newark (R. 931). The "West Coast, New York Office" expense is a portion of that office's expenses prorated to the West Coast, again prorated among the West Coast plants, and finally prorated at Newark among the products there produced, including gypsum (R. 1050, 1051). The "West Coast Exploration" expense is the cost of exploration of mining and new mines, "mines anywhere on the coast" (R. 1051). This

item was allocated among the several plants and again allocated at Newark among the several products, including gypsum (R. 1052). All the items designated as West Coast expenses on the accounting schedule in question pertain to appellee's West Coast operations (R. 930).

Appellee refers (Br. p. 46) to the testimony of its expert Farquhar as to allocations of administrative expense made under certain Navy contracts. What was or was not done in the allocation of administrative expense under contracts between shipbuilders and the Navy, the terms of which are unknown, is irrelevant.

D. Indirect shipping and air compressor charges.

Appellee virtually concedes the error of the court below in permitting the third price increase to include 3 cents per ton caused by its use of inconsistent accounting methods in the periods involved in the cost comparison for these items (Br. p. 48). There is no evidence in the record conflicting with the testimony of the accountants called by appellant, that consistent accounting methods must be employed in the two periods compared (App. Op. Br. p. 41).

Appellee claims as a virtue that it has employed the same accounting procedures with regard to gypsum as have been applied to the other products produced at Newark and that the accounting changes in question were not adopted for the purposes of giving gypsum adverse accounting treatment (Br. pp. 47-48). The question is not the purpose for making the changes, but their effect of producing a fictitious increase on appellee's books in the cost charged to gypsum (App. Op. Br. p. 40).

Eliminating the price increases based on this fictitious cost increase will not mean as appellee suggests (Br. p. 48) that appellee's accounting techniques must remain static. For its own internal purposes, appellee may change its methods of allocation or any other accounting technique whenever and as often as it wishes. For the purposes of this contract, however, such changes may not be used as the basis for increasing the price charged to appellant in respect of items of cost that actually have remained constant.

Appellee has remarked upon the importance appellant attaches to the 3 cent per ton error here involved, although at the time of the first price increase it did not further inquire into the basis for the 3 cent excess of that increase over the 15 cents appellee advised was "accounted for" by increases in labor, materials and power (Br. pp. 32, 48). At the time of the first price increase in the relatively lesser amount of 18 cents per ton, appellant had every reason to believe that appellee's practices were in conformity to the contract, and in that setting quite reasonably paid the increase without further detail. Appellee views very differently, as anyone would, an erroneous charge of 3 cents per ton appearing in the third price increase, after appellee had claimed two increases in the major amounts of 78 cents per ton and 60 cents per ton, and after appellant had long been aware that appellee's practices were objectionable in important respects.

As to appellee's changes in accounting methods with respect to other overhead items than the indirect shipping and air compressor charges, appellee states (Br. p.

49) there is no evidence that such changes resulted either in an increase or decrease in the asserted cost of gypsum. This evidence is lacking because appellee's office manager Watt was to prepare and produce a tabulation showing the effect of these further changes but did not do so (App. Op. Br. p. 43).

E. Straight-line depreciation.

There is a specious appeal in appellee's principal argument concerning its use of the straight-line method of depreciation, namely, that when the quantity of gypsum produced goes down the cost per ton must necessarily go up (Br. pp. 51, 52). The truth of the matter is that the gypsum equipment will last for a certain length of time and during that time a certain quantity of gypsum will be produced. The true unit cost of depreciation is a constant cost for each ton of gypsum produced, obtained by dividing the number of tons produced into the cost of the gypsum equipment. In ordinary circumstances the commonly used straight-line method of depreciation will serve the purpose for which it is intended and for which it is used by appellee—charging off the equipment and creating a reserve adequate to replace it at the end of its useful life (Br. p. 54). That purpose, however, has no relationship whatsoever to the result of using the straight-line method of depreciation for the purpose of calculating price increases under this contract. After the drop in tonnage occurred, which created the 7-cent per ton price increase claimed by appellee in respect of depreciation, the tonnage promptly rose again to more than the initial rate of production (App. Op. Br. p. 47). The result of charging this 7-cent per ton increase to appellant

would therefore be to place in appellee's depreciation reserve an amount far greater than necessary to replace the gypsum equipment.

Appellee's fallacy lies in the assumption that the straight-line method, which is just a convenient device appropriate for the purpose of creating a fund to replace the equipment, is necessarily proper under this contract. This contract is concerned only with the comparison of cost in two accounting periods to ascertain the "*actual advance*" in that cost. The real depreciation cost for each ton of gypsum produced is constant and no "*actual advance*" in that cost takes place merely because the tonnage produced in one accounting period is less than in another.

F. Sulphuric acid.

It is appellee's contention that discontinuance of bromine production in September, 1945 was a basic change in the operating conditions of the plant which required that thereafter the sulphuric acid be charged to gypsum (Br. pp. 54, 56). It appears (Br. p. 54) that from 1930 to 1937, bromine was the only product produced at Newark. Strangely enough, the commencement of gypsum and magnesium production in 1937 is not regarded as a basic change, and although it is said sulphuric acid is necessary to gypsum production (Br. p. 55), no charge for sulphuric acid was made to gypsum at any time after its production began in 1937.

Appellee claims as a "*consistent accounting procedure*" its practice of always charging sulphuric acid to bromine (Br. p. 55). Of course appellant had no occasion to be

concerned with the treatment of sulphuric acid prior to the date when it first appeared in an asserted price increase. There is consistency in that the sulphuric acid charge has never before been made to gypsum. The inconsistency lies in the fact that gypsum was newly charged with sulphuric acid after September, 1945, although sulphuric acid has always served the same function in gypsum production, the process of manufacturing gypsum has remained unchanged, and the sulphuric acid cost has not increased. It may be said equally of gypsum as appellee says of magnesia (Br. p. 56) that "in the entire history of the company there has never been a charge against magnesia for sulphuric acid". The fact that appellee in September, 1945, began charging the sulphuric acid cost to gypsum cannot be claimed by appellee as establishing an "accounting procedure" that it consistently employed from the very inception of its operations (Br. p. 57), for it is the very charge first made to gypsum in 1945 that is the subject of the litigation.

The fallacy of appellee's argument that the cost of sulphuric acid "must be charged somewhere" (Br. p. 57) and "it was essential" to charge it to gypsum (Br. p. 56) is apparent. It does not follow from appellant's argument that the charge for sulphuric acid will have to be made to magnesia. Where appellee charges the sulphuric acid cost for its own purposes, and whether for those purposes it is charged to gypsum or not, is not relevant to this contract. This contract is concerned only with correct comparison of cost of production in two periods to determine the "actual advance" in cost. Appellant urges simply that the gypsum process and the use therein of

sulphuric acid have not changed, there has been no "actual advance" in the cost of manufacture of gypsum in the amount of the new charge for sulphuric acid, and therefore the price to gypsum may not be increased by that amount.

We have already pointed out the intolerable consequence of the argument that the cost of production of gypsum and the "actual advance" in that cost are determined by successive discontinuances and resumptions of production of a different product in a separate portion of the plant, although the gypsum process goes on exactly as before (App. Op. Br. pp. 44, 45).

G. Bittern.

The bittern charge is involved because it is the source material from which the principal product of the plant, magnesium oxide, is derived (App. Op. Br. pp. 8, 9). Its cost is an expense incurred for the production of the primary product, prior to the separation of the by-product (see *supra*, pp. 5, 16). The charge for bittern that is made to gypsum is purely arbitrary. Appellant noted its objection to this item on this ground (App. Op. Br. pp. 18, 51). When asked by the court below what this charge was based on, Mr. Watt testified (R. 1031):

"That is all we can say, your Honor, is that it is just an arbitrary charge."

Here again appellee confuses (Br. p. 58) the question of the cost gypsum may "bear" on its books, with the question as to the type of charges the contracting parties intended to be used in calculating price increases under

this contract. It is not of moment whether on appellee's books gypsum is made to "bear" an arbitrary charge for bittern. It is of moment that changes in cost based on that arbitrary charge may not be reflected in the price charged to appellant. As appellee has observed (Br. p. 58), there was a reduction of 2 cents per ton in this item in connection with the last price increase. It does not otherwise figure in the price increases in litigation.

IV. THE COURT BELOW ERRONEOUSLY BASED ITS DECISION ON THE GROUND THAT APPELLANT HAD THE BURDEN OF PROOF.

Essentially this litigation involves claims made by appellee against appellant for increases in the price of gypsum based upon asserted increases in cost, and appellant's bringing these claims before the court in a declaratory relief suit for a declaration whether it were liable upon these claims. Its basic prayer was that the court declare the rights and other legal relations of the parties under the contract (R. 7). This is the classic example of the case in which the party who is nominally the plaintiff has not the affirmative of the issue and does not bear the burden of proof, as demonstrated by the authorities appellant has cited (App. Op. Br. pp. 54-58). Appellee's principal reliance (Br. pp. 62, 64) is upon *Travelers Ins. Co. v. Drumheller* (W.D.Mo. 1938) 25 F. Supp. 606, which held that the plaintiff always has the burden of proof whether or not it has the affirmative of the issue. This ruling, however, is not the law in that circuit. *Reliance Life Insurance Co. v. Burgess* (8 Cir.

1940) 112 F. 2d 234 “discredits and overrules” the *Drumheller* decision (Borchard, *Declaratory Judgments*, 2d Ed. 1941, p. 407, note 4) (App. Op. Br. p. 56).

Appellee misunderstands the California law on the point (Br. pp. 63, 64, 66). It is clear from Section 1981 of the Code of Civil Procedure of California and from the decisions in *Roadside Rest. Inc., v. Lankershim Estate* (1946) 76 Cal. App. 2d 525, 173 P. 2d 554, and *Dunn v. County of Santa Cruz* (1944) 67 Cal. App. 2d 400, 154 P. 2d 440, that the party having the affirmative of the issue has the burden of proof. In each of the California decisions cited, the plaintiff in the declaratory relief suit did have the burden of proof, but because it had the affirmative of the issue involved in the case, not because it was plaintiff. That portion of Section 1981 of the Code of Civil Procedure of California which states “the burden of proof lies on the party who would be defeated if no evidence were given on either side” does not alter the situation. In a case such as the one at bar, where the defendant has the affirmative of the issue whether it is entitled to the price increases it claims, the defendant would be defeated if it gave no evidence upon that issue, once the plaintiff had established the controversy and the jurisdiction of the court. It would have failed to substantiate the price increases it claimed and asserted in its pleading, and failed to establish its right to relief upon its prayer (R. 33) that the court declare its cost of producing gypsum as determined by it from time to time and the resultant increases in price established by it have been in accordance with the terms and provisions of the contract (*Bauer v. Clark* (7 Cir. 1947) 161 F. 2d 397).

Nor is the situation altered by the fact that, as appellee has put it, appellant's complaint sought "affirmative relief" (Br. p. 67). What appellant sought was a declaratory judgment establishing whether it is liable upon claims made by appellee. Since certain payments for gypsum, in the increased amount claimed by appellee, had been made by appellant under protest, declaratory judgment of appellant's nonliability for the claimed increases would necessarily mean these payments made under protest were not owing, and of course appellant sought a judgment that would determine its right to recover those payments. The basic issue, however, was not whether appellee owed appellant \$9,405.93. The issue was whether appellee was entitled to be paid for gypsum the increased price claimed by it and asserted by it in its pleading.

Appellee's burden of proof did not, as appellee contends (Br. pp. 59, 68), become appellant's burden by reason of the fact that appellant opened and closed at the trial. That situation was before the court in *Standard Accident Ins. Co. v. Cloutier* (1943) 92 N.H. 449, 32 A. 2d 684, a declaratory relief suit in which the defendants made the same contention. The court held (p. 686) that the plaintiff did not waive the evidentiary rule of the burden of proof that was on the defendants, and that the defendants waived the procedural rule by permitting the plaintiff without objection or exception to go forward and have the closing. (See also *Bauer v. Clark* (7 Cir. 1947) 161 F. 2d 397, 401).

Appellee endeavors to show from the pleadings that appellant had the affirmative as to appellant's claimed cost and price increases (Br. pp. 60, 61). Essentially this

is an effort to convert the complaint's negative allegation that appellee's cost "had increased *not more than*" a certain amount, to an allegation that appellee's cost of production "had increased"; to convert the negative allegation that appellee "was entitled to be paid *not more than*" a specified price, into an allegation that appellee "was entitled" to be paid (Br. p. 61). This is mere play upon words.

Appellee considers it would have been necessary for appellant to prove the proper cost figures (Br. p. 62) and states that complete facts and records as to appellee's costs were available to appellant (Br. p. 67). Appellant was permitted to review certain of appellee's books, but it is one thing to have available all records, starting from the original entries of charges for the time of laborers, materials used, and the like, and records bringing those charges forward through various summary books up to their final compilation in the accounting statements; it is another thing to start with the final statements, as appellant had to do, and attempt to trace back through the records to the underlying data for verification. We have noted above that appellee would not divulge certain information as to its research charges (*supra* p. 20), and did not produce its tabulation showing the effect of certain changes in accounting method (*supra* p. 25). In each instance the resulting lack of evidence is now claimed as a benefit to appellee.

Appellee argues (Br. p. 59) that it cannot be ascertained from the record to what extent the trial court "felt" that appellant had the burden of proof. On the contrary, it is clear from the court's opinion that the decision was ex-

pressly based on the conclusion that appellant had the burden of proof. The court pointed out that, in its opinion, the plaintiff had "failed to prove" that the price raises were unjustified and based its ultimate decision upon this ground (R. 73).

V. PARAGRAPH (5) OF THE CONTRACT.

Contrary to appellee's assertion (Br. p. 69), the controversy over the method of sampling is properly in issue. The second count of the complaint (R. 5, 6) involved differences between the parties over deductions under paragraph (5) of the contract, and the complaint prayed that the court declare the proper method of determining the conformity or non-conformity of the gypsum to the specifications (R. 7). Decision on that point does not require, as appellee suggests (Br. pp. 69, 70), inserting in the contract any missing provision.

Whether the gypsum tendered to appellant does or does not conform to the specifications can be determined only by the analysis of samples. The finding by the court below recognized this (R. 57, 58). Appellee concedes that for the purpose of such analysis a sample of "each shipment of gypsum" should be used, but says the aggregate quantity shipped in a 24-hour day is a shipment (Br. pp. 69-70). This clearly is untenable. It is clear that each carload, containing 50 or 55 tons (R. 212, 213), constitutes a shipment. The nine-year use by the parties of samples of each carload makes it clear that they so understood. This is further demonstrated by the fact that sometimes carload shipments go direct to appellant's customers (App. Op.

Br. p. 61). There is no shred of evidence to support the artificial finding by the court below (R. 58) that the aggregate quantity of gypsum shipped to appellant in a 24-hour day constitutes a "shipment."

CONCLUSION.

We respectfully submit that the judgment of the court below is erroneous and should be reversed.

Dated, San Francisco, California,

May 10, 1949.

Respectfully submitted,

MARSHALL P. MADISON,

EUGENE D. BENNETT,

FRANCIS R. KIRKHAM,

WALLACE L. KAAPCKE,

Attorneys for Appellant.

PILLSBURY, MADISON & SUTRO,

Of Counsel.

No. 12,054

IN THE

United States Court of Appeals
For the Ninth Circuit

PACIFIC PORTLAND CEMENT COMPANY, a
corporation,

Appellant,

vs.

FOOD MACHINERY AND CHEMICAL CORPORA-
TION, a corporation,

Appellee.

APPELLANT'S PETITION FOR A REHEARING.

MARSHALL P. MADISON,

EUGENE D. BENNETT,

FRANCIS R. KIRKHAM,

WALLACE L. KAAPCKE,

Standard Oil Building, San Francisco 4, California,

*Attorneys for Appellant
and Petitioner.*

PILLSBURY, MADISON & SUTRO,

Standard Oil Building, San Francisco 4, California,

Of Counsel.

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PAUL P. O'BRIEN, /

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No. 12,054

IN THE
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APPELLANT'S PETITION FOR A REHEARING.

To the Honorable, William Denman, Chief Judge, and William E. Orr, Judge, of the United States Court of Appeals for the Ninth Circuit, and Leon R. Yankwich, Judge of the District Court of the United States for the Southern District of California:

Appellant appreciates the full consideration given by the court to this appeal and does not seek a rehearing upon the principal issue that has been resolved against it. Most earnestly, however, it does seek a rehearing on three subordinate issues for reasons which, we submit, are compelling. These issues involve the propriety of those portions of the price increases based upon (1) General and Administrative Expenses (as distinct from "plant" or

“manufacturing” overhead), (2) the charge to gypsum for New Products Research, and (3) the sulphuric acid charge.

Much of the voluminous record in this case is devoted to a consideration of the principal issue, namely, whether all overhead and indirect charges should be excluded, and we respectfully submit that in the exhaustive attention the court gave to that issue it has been overlooked that there is *no* conflict in the record as to the three subordinate issues above mentioned and *no* substantial evidence to support the decision of the trial court with respect to them.

1. GENERAL AND ADMINISTRATIVE EXPENSES.

The amount here involved is 5 cents per ton of the second price increase and 6 cents per ton of the third (Appellant's Opening Br., pp. 50-51). Production of gypsum in the last 12-month period shown by the record was 36,658 tons (R. 565). Upon an annual production of only 30,000 tons, these amounts would equal \$3300 in a year and approximately \$52,800 over the 16 years from the beginning of the dispute to the end of the contract term. Further increases in which these items might figure would, of course, make these sums even larger.

We note the principle stated by the court that where resort is had to extrinsic evidence to resolve an ambiguity in a contract, the problem of interpretation presents a question of fact (Opinion, p. 17). Counsel for both parties in their briefs and the court in its opinion have cited decisions in other cases involving accounting problems.

Since the problem here presents a question of fact, such decisions are, as appellee itself has stated (Appellee's Br., p. 37), not determinative. The question of fact must be determined upon the record in this particular case.

The record establishes without conflict that only "plant" overhead or "manufacturing" overhead is included in "cost of *production*," "cost of *production*" being distinguished from the general and all-inclusive cost of doing business. General and administrative expenses dissociated from manufacturing operations at the plant are not an element of *production* cost.

Appellee's expert, Farquhar, in answer to the carefully framed questions of appellee's counsel, testified:

"Q. Now, Mr. Farquhar, I am going to ask you to assume that a chemical plant is recovering from a common raw material three different products, which we will designate as products A, B, and C, and I will ask you to assume that product B is technically a by-product in the sense that it consists in part of a chemical element which must be extracted from the raw material in order to produce product C in a pure and salable form. Assume also that in order to convert part of B into a salable commercial product after it is separated from the raw material, it is necessary to process it, and that for that purpose it is necessary to have a physical plant devoted exclusively to such processing, and it is likewise necessary to employ labor which devotes itself exclusively to this processing. And assume further that by reason of contract it is necessary that the manufacturer determine the cost of production of product B. Will you state, in your opinion, whether under these circumstances it is proper and good accounting practice

to include in the cost of production of product B a portion of the overhead *of the plant?**

A. If overhead is what I consider the generally accepted definition, I would say that you cannot obtain true costs of any production without some portion of the overhead, because the line of distinction between direct costs and overhead is an artificial one, largely a practical matter; that costs must include all the elements that go into it, and one of the elements that goes into the production is *the group of things that are generally classified as factory overhead.*

Q. And under the same assumed circumstances, will you state whether or not, in your opinion, it would be proper and good accounting practice to include in the cost of production of product B a portion of the *indirect charges of the plant, such as general superintendence and other charges for labor which are devoted to the production of the several products manufactured in the plant, including product B*, but as to which it is impossible or impracticable to keep records of the time devoted exclusively to each particular product.

A. Well, it is the general nature of overhead that you cannot keep a minute and accurate account of it; that you have to use some devices for allocating it, and it exists; and therefore, to get sound costs, you must absorb that overhead in the various products. And I think that, as I understand, Product B is something that, as you call it a by-product, but if it takes any further processing it must carry—it must absorb in some proportion, depending entirely on the circumstances, all the elements of cost, which would include the items which you mention.” (R. 1110-1112.)

* * * * *

*Italics throughout this petition are supplied by us unless otherwise noted.

“Q. Will you tell us this: Whether or not in accordance with good and accepted accounting practice, it is customary to include *plant overhead* in cost of production of a manufactured product?

A. Well, you can find all stages of accounting practice in cost accounting. There has been a great deal of progress and development in it in recent years, and I think the tendency is to more and more specifically allocate all kinds of costs, either through a machine hour rate, or through a process rate which will gather together in one factor all of these various expenses. Therefore, I will say that it is—anything that tends to absorb in their actual incidence all elements of cost is good accounting practice.” (R. 1115-1116.)

And on cross-examination Mr. Farquhar testified:

“Q. In that sort of situation would you assign to the cost of the by-product the *plant overhead*, a share of the entire overhead of the plant?

A. In so far as it can be allocated to a separate process, if separate process goes on, it immediately picks up some portion of the *plant overhead*.” (R. 1124-1125.)

* * * * *

“Q. Yes. Now, Mr. Farquhar, in these items that you would allocate, how far would you go? You would limit them to the actual allocation of *plant overhead*, would you not?

A. Everything that relates to the *production* of the product.

Q. *Things that don't relate to the production of the product would not be allocated to it?*

A. *Not to the production cost*, but there are other costs that follow on distribution.” (R. 1130-1131.)

Mr. Farquhar would allocate administrative cost to production only where the administration deals with production (R. 1131-1132). Selling expense, for example, is not a cost of *production* (R. 1132). And finally, Mr. Farquhar testified:

“Q. Suppose in a plant they have a certain amount of overhead that has to do with something wholly dissociated from the manufacture of a particular product that you assign as a part of the cost of the product or allocate a part of the cost of that product or portion of that particular item for overhead——

A. If it is dissociated, no.” (R. 1132.)

The record is clear that appellee’s general and administrative expenses, to which objection is made, are general expenses of appellee’s West Coast operations, dissociated from *production* expense at the Newark plant (Watt, R. 931, 1050-1053).

The testimony of appellee’s expert, Maxwell, was the same as that of Farquhar:

“Q. Mr. Maxwell, I will ask you to assume a chemical plant in which from a common raw material three different products are recovered——

A. Yes.

Q. ——which I will refer to as products A, B and C, and I will ask you to assume that product B is technically a by-product in the sense that it consists in part of a chemical element which must be extracted from the raw material in order to produce product C in a pure and salable form. Assume that in order to convert product B into a salable chemical product after it is separated from the raw material, it is necessary to process it, and for the purpose of

such processing it is necessary to have a physical plant devoted exclusively to such processing, and it is likewise necessary to employ labor which devotes itself exclusively to the processing of this material or this product in order to convert it into a merchantable and marketable product; and assume further that by reason of a contract it is necessary that the producer of this product B determine the cost of production or cost of manufacture of that product: Under those circumstances will you state whether or not in your opinion it is proper and good accounting practice to include in the cost of production of product B a portion of the overhead and expense *of the plant?*

A. Oh, yes, certainly; and that is the consensus of opinion of authorities." (R. 1135-1136.)

* * * * *

"Q. (Mr. Rosenberg.) Mr. Maxwell, under the same assumed circumstances, would it be proper and in accordance with good accounting practice to include in the cost of production of this product B a portion of the *indirect charges of the plant, such as general superintendence and other charges for labor which are devoted to the production of the several products*, including product B, but as to which it is impossible or impractical to keep records of the accurate time devoted exclusively to each particular product?

A. Yes, definitely." (R. 1136-1137.)

* * * * *

"Q. All of the overhead *of that plant*, the superintendence, the accounting, the various and sundry and so-called indirect items, you would allocate a portion of them to the actual cost of manufacture of these briquets, would you?

A. Yes, that portion which would be, as far as could be estimated, actually incurred with respect to briquets its fair, scientific share." (R. 1147.)

Appellee's expert, Alexander, agreed with the testimony of both Farquhar and Maxwell (R. 1187), and Alexander also testified:

"Q. I am going to ask you to assume the existence of a chemical plant which is recovering from a common raw material three different products, which I will designate as products A, B, and C, and ask you to assume that product B is technically a by-product in the sense that it consists in part of a chemical element which must be extracted from the raw material in order to produce product C in the pure and salable form, and to assume that in order to convert product B into a salable commercial product after it is separated from the raw material it is necessary to process it, and for the purpose of such processing a physical plant is required which is devoted exclusively to this processing, and labor is employed which is devoted also exclusively to the processing of the product, and I will ask you to assume further that by reason of a contract it is necessary that the manufacturer determine the cost of the production of product B, and under those circumstances will you state whether or not, in your opinion, it is proper and good accounting practice to include in the cost of production of product B a portion of the *plant overhead*?

A. Yes.

Q. And under the same assumed circumstances would it be proper and good accounting practice to include in the cost of production of product B a portion of the *indirect charges of the plant, such as general superintendence and other charges for labor*

which are devoted to the production of the several products, including product B, but as to which it is impossible or impracticable to keep records of the actual time devoted directly and exclusively to each of the particular products?

A. Yes." (R. 1175-1176.)

In regard to all of the testimony of appellee's experts, its own brief (Appellee's Br., p. 45) concedes "the fact that appellee's witnesses testified that only 'factory' or 'plant' overhead should be included * * *."

Appellant's experts also testified that in situations where overhead may be properly chargeable to a product, "cost of production" includes only *manufacturing* overhead, not general and administrative overhead (Pryor, R. 666, 691, 701; Flick, R. 262, 314).

The opinion of the court (p. 21) recognizes that there may be an element of unfairness to appellant in the matter of administration costs; but suggests appellant must accept this since it failed to anticipate and provide in the contract against charges for the administrative costs of a concern greatly expanded through a succession of mergers. We submit that the contract, interpreted in light of the clear record, *does* provide against these charges, which as we have shown are outside the category of "*production*" or "*manufacturing*" costs, to which the parties so carefully confined the contract. The contract permits price increases only when they are based upon increases in the "cost of *production* of gypsum," and expressly limits price increases to "an amount not to exceed the actual advance in California's cost of *manufacture*" (Def. Ex. G, R. 751, 754).

In its discussion of appellee's general and administrative expenses the court comments upon the method of allocating them upon a percentage basis. Appellant does not argue here the *method* of allocation—it urges that there is no substantial evidence upon which any portion of these expenses, by whatever method they might be allocated, can be included in appellee's "cost of *production*" under the contract. The contract and the record, without conflict, require exclusion of this type of expense and require appellant's protection from the element of unfairness recognized by the court.

2. NEW PRODUCTS RESEARCH.

The amount here involved is 12 cents per ton of the second price increase and 4 cents per ton of the third (Appellant's Opening Br., pp. 50-51). Upon an annual production of 30,000 tons, these portions of these two increases alone would amount to \$4800 in a year and approximately \$76,800 over the contract term.

There is no dispute as to the facts regarding the charge for New Products Research. Appellant and appellee are in accord that this is the expense of research projects developing new products to be derived from the raw material, bittern (Appellee's Br., p. 41). It includes the cost of a research project seeking to eliminate gypsum as a product, as testified by appellee's manager, Wallace (R. 1093, 1094).

The record also establishes, without conflict, that as a matter of accounting principle, an item of expense

dissociated from or unrelated to the manufacture of a particular product should not be allocated to the cost of “*production*” or “*manufacture*” of that product (Farquhar, R. 1132, quoted *supra* pp. 5-6). Mr. Flick testified that the New Products Research charge should be eliminated because it is unrelated to gypsum manufacture (R. 292).

It is clear that New Products Research in fact has no relationship whatsoever to gypsum. Accepting the principle that a wholly unrelated expense should not be charged to a product, appellee sought, admittedly by *inference*, to show a connection between New Products Research and gypsum (Appellee’s Br., p. 43), in that if new products were developed, they would bear part of the overhead and reduce the costs charged to gypsum under the contract. The court also recognized the necessity of finding a connection between this charge and the product gypsum, and accepted the suggested *inference* as supplying the link:

“The appellee carried on research, as a part of its operations. As the production of gypsum is an integral part of a larger process of manufacture in which the appellee is engaged, any research which might result in the discovery of new products or new uses for known products, would increase the number of products among which the cost of production should be distributed. *In which event, the appellant’s share would be reduced proportionately*” (Opinion, p. 21).

This inferred benefit to appellant from New Products Research is not only unsupported by any evidence; it is precluded by the contract itself under appellee’s own in-

terpretation—*under paragraph (6) of the contract, price increases that once take effect are never eliminated, nor is the price appellant must pay for gypsum ever reduced when cost goes down* (Appellee's Br., p. 8; Appellant's Reply Br., pp. 17-18). In determining cost increases, costs in any given 12-month period are not compared with costs in any base period, but with costs in the immediately preceding twelve months, and the "escalator" clause works only upward, *not downward*. Unlike prices under a conventional "cost-plus" contract, the price under this contract bears no established relationship to the actual cost level at any given time. Let us assume, for example, that appellee's initial cost of production of gypsum is \$1 per ton, and the price \$2. If that cost rises to \$1.50 per ton, a price increase of 50 cents per ton results, and the price becomes \$2.50. Let us assume further that appellee through its research upon new products discovers a new major product that it begins to produce at Newark; and by distributing a portion of appellee's plant overhead to that product, appellee shows upon its books that the cost of production of gypsum has gone down to 50 cents per ton. Nevertheless, the price of gypsum to appellant *remains the same*—\$2.50 per ton in the example stated. Using the words of the court, "appellant's share" is *not* reduced proportionately, or at all.

While, as the court has stated (Opinion, p. 8), it may make its own inferences from undisputed facts, and while there is no dispute in the record about any of these facts, the *inference* of a potential benefit to appellant from New Products Research is clearly inadmissible and erroneous, and results in most serious prejudice to appellant. The anomaly of charging appellant a higher price based

on the charge for New Products Research is further strikingly illustrated by the admitted fact (R. 1093, 1094) that such charge includes a research project seeking to eliminate gypsum manufacture. Not only would the court's decision require appellant to pay an increased price due to a charge that has no relationship to gypsum manufacture; it would require appellant to pay a higher price based on the cost incurred by appellee in seeking entirely to eliminate the manufacture of gypsum at the Newark plant.

3. THE SULPHURIC ACID CHARGE.

The amount here involved is 23 cents per ton of the third price increase (Appellant's Opening Br., p. 51). Upon an annual production of 30,000 tons, this would amount to \$7900 in a year and approximately \$128,400 over the 16-year period in suit.

The undisputed facts as to this item are that formerly sulphuric acid served a function in the production of both bromine and gypsum. None of the sulphuric acid cost, however, was charged to gypsum. Bromine production was temporarily discontinued, and gypsum remained as the only product for which sulphuric acid was used (Appellee's Br., pp. 55-56).

It is significant that appellee's accounting experts did not testify upon the question as to the sulphuric acid charge. The court rested its decision that appellee could charge the whole cost of sulphuric acid to gypsum upon the inference that the change in assignment of this cost resulted from a change in the processes of production

(Opinion, pp. 25-26). But there was no change in the processes of manufacturing gypsum. The operating change consisted merely of an interruption of production of a separate product in another portion of the plant. Appellee's chemist Melhase testified that when bromine was being produced, the sulphuric acid remained in the bittern after the bromine process (R. 831), and appellee's office manager Watt testified that sulphuric acid has always served the same function in gypsum production, whether or not bromine is produced (R. 1015).

Appellee may suffer loss of revenue when one of its products is eliminated, and may have to absorb expenses formerly defrayed by the sale of that product. When the process of gypsum manufacture remains the same, however; when the same materials are used in producing gypsum, and in the same amounts; when the cost of those materials remains the same, it cannot be inferred that the elimination of that other product constitutes a change in gypsum manufacture, nor that any loss suffered by appellee measures an actual advance in appellee's cost of production of *gypsum*. Again, price increases, under the express language of paragraph (6) of the contract, cannot exceed "the *actual advance* in California's cost of manufacture" of gypsum.

In another and separate particular, the court was also, we submit, seriously mistaken in its decision on the sulphuric acid charge. Adverting to the fact that no part of the sulphuric acid cost was allocated to gypsum when bromine was produced, and that the whole cost was charged to gypsum when bromine was discontinued, the court said:

“So, if the whole cost is now allocated to gypsum, the appellant benefited by the omission of all charges when bromine was produced. Balance is now restored” (Opinion, pp. 25-26).

This inference of a benefit to appellant from the prior omission of the whole charge, and of a restoration of balance when the whole charge was transferred to gypsum, rests upon a fundamental misconception of the nature of the contract. If sulphuric acid were at any time to be charged to gypsum, the prior omission of the whole charge is not a benefit to appellant but imposes upon it an unwarranted penalty. The charge for sulphuric acid, first made to gypsum in the period ending June 30, 1946, was 23 cents per ton. Comparison of that period with the preceding twelve months when nothing was charged to gypsum resulted in an apparent increase due to this item in the full amount of 23 cents per ton. If, however, in the prior period all or a portion of this charge had been allocated to gypsum, the increase would have been smaller by the amount so allocated. So, if all the sulphuric acid had always been charged to gypsum, no price increase based upon this item ever would have occurred. Comparison of any one 12-month period with the preceding one would have shown two identical items of cost—23 cents—with no increase. Again, even if the 23-cent cost for sulphuric acid had been divided equally between bromine and gypsum, gypsum would have borne a sulphuric acid cost of $11\frac{1}{2}$ cents per ton in the twelve months ending June 30, 1945. Comparing that twelve months with the period ending June 30, 1946, when 23 cents per ton was charged to gypsum, the increase would have been only $11\frac{1}{2}$ cents

per ton, and the price of gypsum to appellant would have increased only 11½ cents, not the full 23 cents. It cannot be too strongly emphasized that if appellee had previously charged all or a portion of this cost to gypsum, this fact would not have resulted in any higher price at any earlier time under the contract, which is concerned only with *comparative* costs in any two successive 12-month periods. The presence of an element of cost which is constant has no effect upon the price.

The court's decision as to sulphuric acid is inconsistent, we submit, with its decision on the indirect shipping and compressor charges. In sustaining appellant's position on those items, the court perceived that consistency is required in the accounting methods employed in two accounting periods being compared, and stated that

“The accounting method of the later period should have been applied to the figures of the earlier period to determine the difference, if any, of the costs in the two periods” (Opinion, p. 23).

The same principle controls the sulphuric acid charge. Assuming *arguendo* that some charge to gypsum for sulphuric acid were proper, such charge should be made in *both* the accounting periods compared. The “actual advance in California's [appellee's] cost of manufacture” of gypsum, to which the contract limits any price increases, could not exceed the difference between the portion of sulphuric acid cost gypsum should formerly have borne and the later full charge for sulphuric acid.

CONCLUSION.

For the reasons above stated, we respectfully request that a rehearing be granted as to the three issues above discussed, and that this court reverse the judgment of the district court upon those issues.

Dated, San Francisco, California,
December 30, 1949.

Respectfully submitted,

MARSHALL P. MADISON,

EUGENE D. BENNETT,

FRANCIS R. KIRKHAM,

WALLACE L. KAAPCKE,

*Attorneys for Appellant
and Petitioner.*

PILLSBURY, MADISON & SUTRO,
Of Counsel.

CERTIFICATE OF COUNSEL.

I hereby certify that I am one of the counsel for appellant and petitioner in the above-entitled cause and that in my judgment the foregoing petition for a rehearing is well founded in point of law as well as in fact, and that said petition for a rehearing is not interposed for delay.

Dated, San Francisco, California,
December 30, 1949.

WALLACE L. KAAPCKE,
Attorney for Appellant and Petitioner.

